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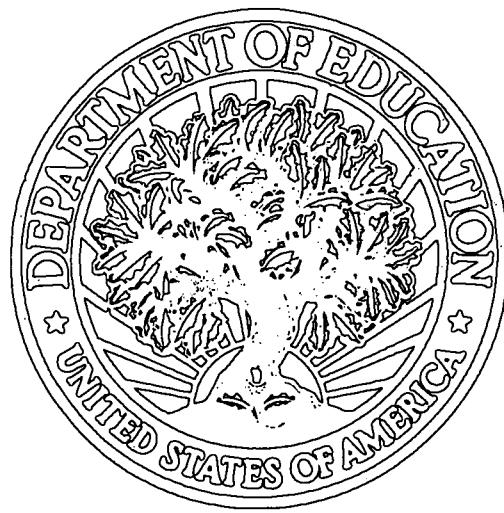
ABSTRACT

This guide provides new direction in financial management and oversight practices for accounting and charging administrative costs as they relate to programs administered by the U.S. Department of Education. The document is divided into six sections. Section 1, which presents general information, offers details on definitions; indirect-cost rates; the determination of indirect-cost rates; the submission of indirect-cost rate proposals; the application of indirect-cost rates; requirements for reimbursement, approval, negotiation agreements, and disputes; indirect-cost limitations; and the retention of records. The second section offers guidelines for preparing indirect-cost-rate proposals and includes basic steps, the indirect-cost rate allocation bases, the indirect-cost-rate proposal documentation, and certificate of indirect costs. Section 3 provides five examples of indirect-cost-rate proposals, using such methods as the simplified (single rate) method, and section 4 examines state education agency responsibilities, such as the policy for subrecipients other than state or local units of government. Section 5 offers guidance on various issues, such as common indirect-cost problems, answers to common review questions, time distribution, and administration and indirect-cost claims. The last section answers some frequently asked questions. Eight appendices include: OMB Circular A-87; U.S. Dept. of Education Cognizant Agency Assignments under OMB Circular A-87; Education Dept. General Administrative Regulations, 34 CFR Parts 75 and 76; a listing of Restricted Rate Programs (New); an indirect cost rate agreement; a sample methodology for a local education agency; a sample local education agency proposal format; and State Education Agency Delegation for Local Education Agency Indirect Cost Rates. (RJM)

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# U.S. DEPARTMENT OF EDUCATION

## Indirect Cost Determination Guidance for State and Local Government Agencies



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## **U.S. DEPARTMENT OF EDUCATION**

### **Indirect Cost Determination Guidance for State and Local Government Agencies**

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**1997**



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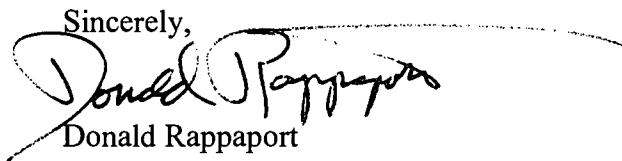
Dear Educational Federal Financial Administrators:

The Office of Management and Budget recently issued revisions to Circular A-87, Cost Principles for State, Local and Indian Tribal Governments. These revisions, which are the first substantive changes made to this document in twenty years, are guided by objectives of fairness, efficiency, and consistency, and have resulted in changes to current guidelines on preparing cost allocation plans. This Guide provides new direction about financial management and oversight practices for accounting and charging administrative costs particularly as they relate to programs administered by the U.S. Department of Education.

Financial stewardship supports our performance partnership and is a cornerstone of our efforts to advance education in America today. The current environment of changing technology, administrative flexibility, and business management provides us with a challenging opportunity to balance accounting innovations with prudent oversight policy. In this regard, we have a mutual responsibility to develop administrative efficiencies that improve outcomes, particularly where classrooms benefit.

I hope this Guide is helpful in strengthening our financial performance partnership and welcome your comments.

Sincerely,



Donald Rappaport

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# **SECTION I**

## **GENERAL INFORMATION**

## SECTION I

### GENERAL INFORMATION

#### A. Authority

OMB Circular A-87, "Cost Principles for State, Local and Indian Tribal Governments," establishes the policy that one federal agency is responsible for the review, negotiation and approval of indirect cost rate proposals prepared by state and local government agencies. The U.S. Department of Education (ED) has been delegated as the cognizant agency for those state and local agencies listed in Appendix II. \*

In accordance with 20 U.S.C. 1221e.3(a)(1), 2831(a), the Secretary approves an indirect cost rate for a state agency and for a subgrantee other than a local education agency. Each state education agency, on the basis of a plan approved by the Secretary, shall approve an indirect cost rate for each local educational agency that requests it to do so. In ED, the Secretary has redelegated this authority to the Office of the Chief Financial Officer.

#### B. Definitions

For the purpose of this Guide, the following definitions of key terms apply. They were taken from OMB Circular A-87 and the Education Department General Administrative Regulations (EDGAR).

**"State"** means any of the 50 states, the Commonwealth of Puerto Rico, the District of Columbia, Guam, American Samoa, the Virgin Islands, the Northern Mariana Islands, or the Trust Territory of the Pacific Islands.

**"State Education Agency"** means the state board of education or other agency or officer primarily responsible for the supervision of public elementary and secondary schools in a state. In the absence of this officer or agency, it is an officer or agency designated by the Governor or state law.

**"Local Government"** means a county, municipality, city, town, township, local public authority, school district, special district, intrastate district, council of governments (whether or not incorporated as a non-profit corporation under state law), any other regional or interstate government entity, or any agency or instrumentality of a local government.

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\* All references to Appendices, Exhibits and Sections relate to "contents" that are included in this Guide.

**"Local Education Agency"** means:

- (a) A public board of education or other public authority legally constituted within a state for either administrative control of or direction of, or to perform service functions for, public elementary or secondary schools in:
  - (1) A city, county, township, school district, or other political subdivision of a state; or
  - (2) Such combination of school districts or counties a state recognizes as an administrative agency for its public elementary or secondary schools; or
- (b) Any other public institution or agency that has administrative control and direction of a public elementary or secondary school.
- (c) As used in 34 CFR parts 400, 408, 525, 526 and 527 (vocational education program), the term also includes any other public institution or agency that has administrative control and direction of a vocational education program.

**"Grantee"** means the agency of the state and local government to which a grant is awarded and which is accountable for the use of the funds provided. The grantee is the entire legal entity even if only a particular component of the entity is designated in the grant award document.

**"Subgrantee"** means the government or other legal entity which a subgrant is awarded and which is accountable to the grantee for the use of the funds provided.

**"Cognizant Agency"** means the federal agency which, on behalf of all federal agencies, is responsible for reviewing, negotiating, and approving cost allocation plans or indirect cost proposals under OMB Circular A-87.

**"Central Service Cost Allocation Plan"** means the documentation identifying, accumulating, and allocating or developing billing rates based on the allowable costs of services provided by a governmental unit on a centralized basis to its departments and agencies. Attachment C to OMB Circular A-87 provides guidance on State/Local-Wide Central Service Cost Allocation Plans.

**"Indirect Cost Rate Proposal"** means the documentation prepared by a governmental unit or component thereof to substantiate its request for the establishment of an indirect cost rate as described in Sections II and III.

**"Indirect Cost Rate"** is a device for determining in a reasonable manner the proportion of indirect costs each program should bear. It is the ratio (expressed as a percentage) of the indirect costs to a direct cost base. The direct cost base selected should result in each program bearing a fair share of the indirect costs in reasonable relation to the benefits received from the costs.

**"Indirect Costs"** are those that have been incurred for common or joint purposes. These costs benefit more than one cost objective (e.g., federal award, state project or activity) and cannot be readily and specifically identified with a particular final cost objective without effort disproportionate to the results achieved. Indirect costs include (a) the indirect costs originating in each department or agency of the governmental unit carrying out federal awards and (b) the costs of central service cost allocation plan not otherwise treated as direct costs.

### C. Indirect Cost Rates

#### **"Unrestricted" vs. "Restricted" Rates**

Certain ED grant programs have a statutory requirement prohibiting the use of federal funds to supplant non-federal funds. These programs require the use of a **restricted indirect cost rate**, computed under 34 CFR 76.564-76.569. A list of programs subject to the restricted rate are listed by Catalog of Federal Domestic Assistance number in Appendix IV. Normally, the **unrestricted rate** must be calculated first, then converted to the **restricted rate**. This is accomplished by removing certain items from the indirect cost pool and placing them in the direct cost base for computational purposes. An example is shown as Exhibit C in Section III. This results in a lesser rate to claim indirect cost reimbursement under restricted rate programs. **State and local units of government have the option to use the lower restricted rate for all programs to:** 1) accomplish administrative expediency for budgeting, auditing and financial planning; 2) increase the flow of federal funds for direct project purposes; and 3) meet the "reasonable assurance" criteria required for use of predetermined rates described at OMB Circular A-87, Attachment E - Item 2.

**"Rate Types"** OMB Circular A-87 provides for the use of predetermined, fixed, provisional and final indirect cost rates on federal awards. These rates are defined below:

**"Predetermined Rate"** means an indirect cost rate, applicable to a specified current or future period, usually the governmental unit's fiscal year. This rate is based on an estimate of the costs to be incurred during the period. Except under very unusual circumstances, a predetermined rate is not subject to adjustment. (Because of legal constraints, predetermined rates are not permitted for federal contracts; they may, however, be used for grants or cooperative agreements.) In view of the potential advantages offered by this procedure, negotiation of predetermined rates for indirect costs for a period of two to four years is used when the cost experience and other pertinent facts

available are deemed sufficient to evaluate past cost experience and project future costs. This will enable the parties involved to reach an informed judgment as to the probable level of indirect costs during the ensuing accounting periods. The cognizant agency needs reasonable assurance that the predetermined rate will not exceed the rate base on actual costs for the rate period.

"**Fixed Rate with Carry-Forward**" means an indirect cost rate which has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual, allowable costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period. The carry-forward computation is shown in Exhibit D, Section III. The fixed rate with a carry-forward adjustment will not work in a governmental unit where costs fluctuate to such an extent that cost projections are unreliable, or when organizational changes are imminent.

"**Provisional Rate**" means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on federal awards pending the establishment of a "final rate" for that period.

"**Final Rate**" means an indirect cost rate applicable to a specified past period which is based on the actual allowable costs of the period. A final audited rate is not subject to adjustment.

Many state government agencies for whom the ED is the cognizant agency use the Fixed Rate With Carry-Forward provision, for both restricted and unrestricted programs. Where the ED determines that cost experiences and other pertinent facts do not justify the use of predetermined rates, or a fixed rate with carry-forward, or if the parties cannot agree on an equitable rate, a provisional rate shall be established. To prevent substantial overpayment or underpayment, the provisional rate may be adjusted by the ED during the grantee's fiscal year. Predetermined or fixed rates may replace provisional rates at any time prior to the close of the grantee's fiscal year. (If a provisional rate is not replaced by a predetermined or a fixed rate prior to the end of the grantee's fiscal year, a final rate will be established. Any upward or downward adjustments will require specific financial adjustments under official Federal awards.

#### D. Determination of Indirect Cost Rates

The two basic methods for calculating indirect cost rates under OMB Circular A-87, are the Simplified and the Multiple Allocation Base Methods. OMB Circular A-87 also provides for the use of Special (Restricted) Indirect Cost Rates for those few federal grant programs which are prohibited by statute to pay for the full recovery of indirect costs.

The President's National Performance Review and new OMB Circular A-87 both stress the need for federal agencies to work with state agencies on (1) streamlining accounting processes; (2) reducing the burden of maintaining systems for charging administrative costs to federal programs; and (3) simplifying the preparation and approval of cost allocation plans.

Therefore, organizations are encouraged to use the simplified, single rate method whenever possible and never to exceed the complexity of the multiple allocation base method. ED considers any double iterative variations of the simplified and multiple allocation base methods as excessive, complex and burdened with extraneous detail that encumbers the review and approval process. Therefore, any deviations from the methods shown in Section III need prior approval from ED.

***The Simplified, or Single Rate Method*** is used whenever a governmental grantee has only one major function encompassing a number of individual projects or activities that benefit from its indirect costs *to approximately the same degree*. The allocation of indirect costs may be accomplished by (1) classifying the grantee agency's total costs for the base period as either direct or indirect and (2) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. This is the most commonly used method.

***The Multiple Allocation Base Method*** is used whenever a governmental grantee's indirect costs benefit its major functions in varying degrees. Such costs shall then be accumulated into separate cost groupings and allocated individually to the benefitted direct functions by means of a base which best measures the relative benefits for each function. This method is less commonly used than the single rate method, because the level of effort required to maintain multiple rates usually offsets the relative benefits. Examples and specific instructions on the computation of indirect cost rates with the conditions on when to use each method are contained in Exhibits A and B, Section III.

***Special Indirect Cost Rates*** must be determined whenever different factors such as the physical location of the work may substantially affect the indirect costs applicable to a particular program or group of programs. Also, ***Special (Restricted) Indirect Cost Rates*** must be determined when federal statutes restrict the reimbursement of indirect costs (e.g., ED programs which require the use of a *Restricted Indirect Cost Rate*, computed under 34 CFR 76.564-76.569, are listed in Appendix IV).

#### **E. Submission of Indirect Cost Rate Proposals**

An indirect cost rate proposal, together with supporting documentation listed in Section II.C. must be developed (and when required) submitted on an annual basis to ED no later than six months after the close of the governmental unit's fiscal year, unless an exception is approved by ED.

If the proposed central service cost allocation plan for the same period has not been approved by the cognizant federal agency, the indirect cost proposal may be prepared using an amount for central services that is based on the latest approved central service cost allocation plan. The difference between these central service amounts and the amounts ultimately approved will be compensated for by an adjustment in a subsequent period.

The indirect cost rate proposal is to be submitted to:

U.S. Department of Education  
Attn.: Indirect Cost Group  
600 Independence Avenue, S.W.  
Room 3523, ROB #3  
Washington, D.C. 20202-4201

## F. Application of Indirect Cost Rates

The dollar amount of indirect costs allocable to a grant or contract will be determined by multiplying the approved indirect cost rate by the direct cost base of the grant or contract. The typical direct cost bases are listed in Section II (B).

**For purposes of illustrating the application of indirect cost rates, assume an ED state government recipient has an approved indirect cost rate as follows:**

Type	From	To	Rate	Base	Location	Coverage
Fixed	07/01/95	06/30/96	17.0%	(1)	All	Unrestricted
Fixed	07/01/95	06/30/96	9.0%	(1)	All	Restricted (2)

- (1) Total direct costs less equipment purchases, alterations and renovations, the portion of each subaward exceeding \$25,000, and flow-through funds.
- (2) All federal programs which require the use of a "Restricted Rate" as defined by 34 CFR 75.563 and 34 CFR 76.563.

**From July 1, 1995 through December 31, 1995, the recipient has incurred the following costs on its ED grants:**

	Unrestricted	Restricted	Notes
	Grants	Grants	
Personnel	\$198,000	\$267,300	1
Other Direct	126,000	187,200	2
Equipment	26,100	15,300	3
Subcontracts	65,700	89,100	4
Flow-Through	<u>1,276,200</u>	<u>2,349,000</u>	5
Total Direct	<u>\$1,692,000</u>	<u>\$2,907,900</u>	<u>\$4,599,900</u>

### **Notes:**

- 1 Includes fringe benefits.
- 2 Includes Travel, Supplies, Equipment with unit cost less than \$5,000, and other costs that generate and/or benefit from the organization's indirect costs.
- 3 Equipment purchases with unit costs of \$5,000 or more (OMB Circular A-87, Attachment B(19)(a)(2)).
- 4 Subaward under "Unrestricted" grant - total \$65,700. First \$25,000 is part of base, and indirect costs are billed on it. The remaining \$40,700 (and any remaining costs on this award through June 30, 1996) do not have indirect costs billed on them.
- 5 Flow-Through represent funds provided to the grantee and subsequently passed through to another organization which actually conducts the program for which the funds are provided.

### **Subaward expenses under "Restricted" awards:**

	Expenses	Subject to Indirect
Subaward A	\$24,300	\$24,300
Subaward B	<u>64,800</u>	<u>25,000</u>
Total	\$89,100	\$49,300

## INDIRECT COST BILLINGS:

	<u>Unrestricted Grants:</u>		<u>Restricted Grants:</u>	
	Total Costs	Subject to Indirect	Total Costs	Subject to Indirect
Personnel	\$198,000	\$198,000	\$267,300	\$267,300
Other Direct	126,000	126,000	187,200	187,200
Equipment	26,100	0	15,300	0
Subcontracts	65,700	25,000	89,100	49,300
Flow-Through	<u>1,276,200</u>	<u>0</u>	<u>2,349,000</u>	<u>0</u>
Totals	<u>\$1,692,000</u>	<u>\$349,000</u>	<u>\$2,907,900</u>	<u>\$503,800</u>
Indirect Cost Rate		<u>17.0%</u>		<u>9.0%</u>
Indirect Cost Billings		<u>\$ 59,330</u>		<u>\$45,342</u>

### **G. Requirements for Reimbursement**

In order for costs to be reimbursed on grants or contracts awarded by the ED, they must meet the following tests as required by OMB Circular A-87, Attachment A.

- ( 1 ) Be necessary and reasonable for proper and efficient performance and administration of federal awards.
- ( 2 ) Be allocable to federal awards under the provisions of this Circular.
- ( 3 ) Be authorized or not prohibited under state or local laws or regulations.
- ( 4 ) Conform to any limitations or exclusions set forth in these principles, federal laws, terms and conditions of the federal award, or other governing regulations as to types or amounts of cost items (e.g., use of restricted rates as defined by 34 CFR 75.563 and 76.563).
- ( 5 ) Be consistent with policies, regulations, and procedures that apply uniformly to both federal awards and other activities of the governmental unit.
- ( 6 ) Be accorded consistent treatment. A cost may not be assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the federal award as an indirect cost.

- (7) Except as otherwise provided for in this Circular, be determined in accordance with generally accepted accounting principles.
- (8) Not be included as a cost or used to meet cost sharing or matching requirements of any other federal award in either the current or a prior period, except as specifically provided by federal law or regulation.
- (9) Be the net of all applicable credits.
- (10) Be adequately documented.

## H. Approval

The Indirect Cost Group will negotiate and approve indirect cost rates when the ED is the cognizant federal agency. Local Education Agencies shall submit their indirect cost rate proposals to State Education Agencies for approval (refer to Section IV for procedures). Where a local government only receives funds as a sub-recipient, the primary recipient will be responsible for approval of the sub-recipient's indirect cost rate proposal.

## I. Negotiation Agreement

The approval will be formalized by a rate agreement signed by ED's Chief, Indirect Cost Group and an authorized representative of the governmental organization. Each agreement will include:

- (1) The approved rate(s) and information directly related to the use of the rates, e.g., type of rate, effective period, and distribution base;
- (2) The treatment of fringe benefits as either direct and/or indirect costs, or an approved fringe benefit rate;
- (3) General terms and conditions; and
- (4) Special remarks.

The rate agreements are reproduced and distributed to ED offices and the U.S. Department of Health and Human Services for publication in its Government-wide system. A sample copy of the agreement used by the ED is shown as Appendix V of this Guide.

## **J. Disputes**

If a dispute arises in a negotiation of an indirect cost rate (or other rate) between the ED and the grantee, the concern may be raised to the Chief Financial Officer for review. The ED Appeals Board only has authority to review disputes over issues involving funds recovery actions under specific ED programs.

## **K. Indirect Cost Limitations**

Reimbursement of indirect costs is subject to the availability of funds and statutory or administrative restrictions. Statutory limitations include the supplement but not supplant restriction discussed in Section II (A).

When the amount allowable under a statutory limitation is less than the amount otherwise allocable as indirect under OMB Circular A-87, the amount not recoverable as indirect costs may not be shifted to another federal financial assistance program unless specifically authorized by legislation.

## **L. Retention of Records**

In accordance with the provisions of 34 CFR Part 74, Subpart D - Retention and Access Requirements for Records, records shall be retained for 3 years as follows:

- o If the indirect cost rate proposal, cost allocation plan, or other computation **are required** to be submitted to the federal government (or to the grantee) to form the basis for negotiation of a rate(s), then the 3-year retention period for its supporting records starts from the date of such submission.
- o If the above types of documents **are not required** to be submitted to the federal government for negotiation purposes, then the 3-year retention period for its supporting records starts from the end of the fiscal year (or other accounting period) covered by the indirect cost rate proposal, cost allocation plan, or other computation.

## **SECTION II**

# **GUIDELINES FOR PREPARING INDIRECT COST RATE PROPOSALS**

## **SECTION II**

### **GUIDELINES FOR PREPARING INDIRECT COST RATE PROPOSALS**

#### **A. Basic Steps**

The following steps are suggested for use by governmental organizations for the preparation of an indirect cost rate proposal subject to OMB Circular A-87 and Education Department General Administrative Regulations, 34 CFR Parts 75 and 76, which are included as Appendix III.

##### **1. Determination of Unrestricted Indirect Cost Rate Method**

In selecting the simplified or multiple allocation base method, the governmental organization should consider the following:

- a. Organizational structure.
- b. Level of federal funding.
- c. Reports generated from their accounting system.
- d. Availability of data on square footage, number of transactions, employees, purchase orders, etc.
- e. Additional effort and cost required to achieve a greater degree of accuracy.

Examples on the computation of indirect cost rates with the conditions on when to use each method are contained in Exhibits A and B, Section III.

##### **2. Determination of Need for Special (Restricted) Indirect Cost Rates**

Certain ED grant programs have a statutory requirement prohibiting the use of federal funds to supplant non-federal funds. These programs require the use of a **restricted indirect cost rate**, computed under 34 CFR 76.564 - 76.569. A list of programs subject to the restricted rate, by the Catalog of Federal Domestic Assistance Number, is in Appendix IV.

The governmental agency needs to review this list in order to determine whether a restricted rate is necessary. In such cases, the unrestricted rate, using the simplified or multiple allocation base method, must be calculated first, then converted to the restricted rate. This is accomplished by removing certain items from the indirect cost pool and placing them in the direct cost base. The restricted rate conversion is illustrated in Exhibit C, Section III. Also, refer to Section VI for questions and answers relating to the computation of the restricted rate.

### **3. Identify Any Unallowable and Excluded Items of Cost**

Prior to the computation of an indirect cost rate, the organization should review OMB Circular A-87, Attachment B (Appendix I), to determine which items of cost are unallowable for reimbursement on federal programs or are to be excluded from either the indirect cost pool or distribution base. This is an important distinction because Office of Management and Budget Circular A-87, Attachment A (C) (3) (b) states:

All activities which benefit from the governmental unit's indirect costs, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.

This means that all non-indirect costs that are supported by allowable indirect activities, including unallowable activities (e.g., fund raising and lobbying), costs incurred on awards from nongovernmental organizations, and the imputed costs of donated services (e.g., adjunct professors), will be placed in the base when calculating indirect cost rates. The only items that would be excluded are capital outlays and other distorting items.

Below are three examples of funds awarded to a state agency. Which helps explain when costs are included in the indirect cost base (denominator when calculating the indirect cost rate), and when should they be "Excluded" from the base or pool.

A. The agency receives a \$1,000,000 award from federal agency X. The purpose of the award is for School Districts to conduct seminars on new federal program X. The agency awards \$100,000 to each of 10 selected districts. Each of the ten school districts is responsible for payroll, issuing contracts and purchase orders, acquiring and paying for supplies, reimbursement for travel, and other similar administrative costs. The only efforts the agency spends on these awards are:

- Receiving and reviewing end-of-year financial reports at the end of the fiscal year.
- Issuing checks for total claimed expenses at end of the fiscal year.

### Accounting Treatment

*All \$1,000,000 are “pass-through” and therefore Excluded. There is minimal benefit these funds received from the agency. For each school district, the amount it spent on the sub-award is part of the base for their indirect cost rate.*

B. State agency receives a \$500,000 grant from a corporate endowment to improve mathematics instruction in the state. The endowment does not allow indirect costs under its grants. The agency hires five full-time staff with these funds. The state agency pays their salaries, fringe benefits, local travel, supplies, and other expenses.

### Accounting Treatment

*All expenses incurred under this endowment grant are placed in the state agency’s base (except distorting items such as equipment purchases). It does not matter whether the endowment allows indirect costs or not. (Nor does it matter who the grantor agency is). These costs benefit from the agency’s allowable indirect costs (payroll, personnel, procurement, data processing, etc.). Therefore, according to OMB Circular A-87, Attachment C (3) (b), they are placed in the base. (If they are not, in effect the agency’s federal programs would be charged a portion of the costs of administering the endowment grant).*

C. On a federal grant, the agency subawards \$300,000 to “Non Profit A” and \$300,000 to “Non Profit B.” “A” hires three staff, pays their salaries and benefits, and also pays their travel, supplies, and other operating expenses. “B” also hires three staff, who incur salary and benefits costs, as well as similar supporting costs. However, the state agency performs these functions for the staff hired by “B” on its subaward.

### Accounting Treatment

*The costs incurred by “A” are excluded, as the agency has minimal if any administrative efforts in support of these expenses. They would be part of “B’s” indirect cost base.*

*The costs incurred by “B” are included in the agency’s indirect cost base, as they benefit from allowable indirect costs by the state agency. They would be excluded from “B’s” indirect cost base.*

**4. Select the Bases of Distribution for the Indirect Costs**

The direct cost base (distribution base) selected should be the one best suited for assigning the indirect costs to all cost objectives in accordance with the relative benefits received. The distribution bases that are commonly used are listed in Paragraph B. below. **The Restricted Rate requires a Modified Total Direct Cost (MTDC) Base (34 CFR 76.567).**

**5. Computation of Indirect Costs Rates; Unrestricted and Restricted, and Carry-Forward Amount**

Using the results of Steps 1-4 above and the indirect cost proposal formats shown in Section III, compute the appropriate indirect cost rate(s). Also, if the organization is using a fixed rate with a carry-forward provision, compute the amount of the carry-forward using the methodology shown in Exhibit D, Section III.

**6. Prepare Reconciliation of Proposal to Financial Statements**

Reconcile the indirect cost rate proposal to the audited financial statements. Any differences need to be explained. An example of this reconciliation is shown in Exhibit E, Section III.

**B. Indirect Cost Allocation Bases**

The typical direct cost bases used for allocating indirect costs are:

1. Direct salaries and wages including vacation, holiday, and sick pay but excluding other fringe benefits;
2. Direct salaries and wages including or excluding applicable fringe benefits; and
3. Total direct cost excluding capital equipment purchases, the portion of each subaward in excess of \$25,000, alterations/renovation, flow-through funds, or any other direct cost which may distort the distribution of indirect costs to benefiting activities. This base is commonly referred to as a **Modified Total Direct Cost Base**.

C. Indirect Cost Rate Proposal Documentation

New recipients will receive a packet of information containing an introductory letter, a listing of ED programs requiring the use of a restricted rate, and EDGAR (Education Department General Administrative Regulations).

*Data Required with Indirect Cost Proposal Submission:*

- (1) A chart showing the organizational structure of the agency during the period for which the proposal applies, along with a functional statement noting the duties and/or responsibilities of all indirect units within the agency. (Once this is submitted, only revisions need be submitted with subsequent proposals.)
- (2) A copy of the financial data (financial statements, budgets, accounting reports, etc.) upon which the rate is based. Adjustments resulting from the use of unaudited data will be recognized, where appropriate, by the federal cognizant agency in a subsequent proposal.
- (3) The approximate amount of direct base costs incurred under federal awards. These costs should be broken out between salaries and wages and other direct costs.
- (4) The rates proposed, including subsidiary worksheets and other relevant data cross-referenced and reconciled to the financial data in item (2); e.g., reconciliation of the indirect cost proposal to the audited financial statements. Allocated central service costs will be supported by the summary table included in the signed copy of the organization's approved Statewide Cost Allocation Plan.
- (5) A completed Certificate of Indirect Costs.  
(Refer to Paragraph D, on the next page)
- (6) A listing of grants and contracts by federal agency, total dollar amount, period of performance, and the indirect cost limitations (if any) applicable to each, such as ceiling rates or amounts restricted by administrative or statutory regulations.

#### **D. CERTIFICATE OF INDIRECT COSTS**

This is to certify that I have reviewed the indirect cost rate proposal submitted herewith and to the best of my knowledge and belief:

(1) All costs included in this proposal dated [identify date] to establish billing or final indirect cost rates for [identify period covered by rate] are allowable in accordance with the requirements of the federal award(s) to which they apply and OMB Circular A-87, "Cost Principles for State, Local and Indian Tribal Governments." Unallowable costs have been adjusted for in allocating costs as indicated in the cost allocation plan.

(2) All costs included in this proposal are properly allocable to federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently and the federal government will be notified of any accounting changes that would affect the predetermined rate.

I declare that the foregoing is true and correct.

Governmental Unit: \_\_\_\_\_

Signature: \_\_\_\_\_

Name of Official: \_\_\_\_\_

Title: \_\_\_\_\_

Date of Execution: \_\_\_\_\_

## **SECTION III**

### **SAMPLE INDIRECT COST RATE PROPOSALS**

## **EXHIBIT A**

### **Simplified (Single Rate) Method**

## **Exhibit A**

### **SIMPLIFIED (SINGLE RATE) METHOD [Unrestricted Indirect Cost Rate]**

The Simplified, or Single Rate Method is used whenever a grantee agency's major functions benefit from its indirect costs to approximately the same degree. The allocation of indirect costs may be accomplished by (1) classifying the grantee agency's total costs for the base period as either direct or indirect and (2) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base.

The result of this process is an indirect cost rate which is used to distribute indirect costs to individual federal financial assistance programs. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where a grantee department or agency has only one major function encompassing a number of individual projects or activities, and may be used where the level of federal awards to that department or agency is relatively small.

Both the direct costs and the indirect costs shall exclude capital expenditures and unallowable costs. However, unallowable costs must be included in the direct cost base (if they represent activities to which the indirect costs are properly allocable.)

The distribution base may be (1) total direct costs (excluding capital expenditures and other distorting items, such as flow-through funds, the portion of each subaward in excess of \$25,000, etc.), (2) direct salaries and wages, or (3) another base which results in an equitable distribution.

A sample format for the computation of an unrestricted indirect cost rate under the simplified method follows.

**EXHIBIT A**  
**SAMPLE - EDUCATION DEPARTMENT/AGENCY**  
**INDIRECT COST RATE PROPOSAL - SIMPLIFIED METHOD**  
**FOR THE YEAR ENDED JUNE 30, 199X**  
**[UNRESTRICTED RATE]**

	<b>(a) Total Costs</b>	<b>(b) Excluded Costs</b>	<b>(c) Unallowable Costs</b>	<b>Direct Costs (e)</b>		<b>Indirect Costs</b>
				<b>Salaries &amp; Wages</b>	<b>Other</b>	
<b>DIRECT ACTIVITIES</b>						
Board of Education	\$988,200	\$ 171,990,000	\$65,700	\$765,200		\$167,300
Elementary Education	180,900,000	180,490,000	55,000	7,887,800		987,200
Secondary Education	201,900,000	10,500	1,500,000	14,004,700		6,905,300
Adult Education	11,14,600	3,000,000	1,400,000	7,806,000		2,398,100
Food Services	4,977,900		200,000	983,700		794,200
Pupil Transportation	1,338,100		20,000	891,900		426,200
<b>Subtotal Direct Activities</b>	<b>\$401,718,800</b>		<b>\$355,490,600</b>	<b>\$32,240,700</b>		<b>\$10,648,300</b>
<b>DEPARTMENTAL INDIRECT</b>						
Secretary of Education	\$369,900					\$369,900
Legal Counsel	486,000					486,000
Comptroller	356,300					356,300
Human Resources	523,800					523,800
Information Services	487,200					487,200
Business Management	784,800					784,800
Occupancy	484,800					484,800
Equipment Use (d)	146,800					146,800
<b>Subtotal Departmental Indirect</b>	<b>\$1,639,400</b>					<b>\$1,639,400</b>
<b>CENTRAL SERVICES (f)</b>						
Personnel	\$162,100					\$162,100
Accounting	139,800					139,800
Purchasing	113,400					113,400
Audit	82,300					82,300
<b>Subtotal Central Services</b>	<b>\$497,600</b>					<b>\$497,600</b>
<b>Total Costs</b>	<b>\$406,255,800</b>		<b>\$355,490,600</b>	<b>\$32,240,700</b>		<b>\$10,648,300</b>
Rate = Indirect Costs Divided by Total Base						
Indirect Costs						
Direct Costs						
Salaries & Wages	\$32,339,300					
Other	10,648,300					
Total Base						

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Rate =	<u>9.62%</u>
Indirect Costs	
Direct Costs	
Salaries & Wages	\$32,339,300
Other	10,648,300
Total Base	<u>\$42,987,600</u>

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NOTE: THE COSTS INCLUDED IN THIS EXHIBIT ARE FOR ILLUSTRATIVE PURPOSES ONLY.

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## **Exhibit A - Simplified (Single Rate) Method**

### **Notes to Exhibit A**

- (a) This amount should be reconciled to the financial statements or other supporting documentation submitted with the proposal and would include costs billed from the Central Service Cost Allocation Plan as well as the agency's costs.
- (b) Under some federal programs, funds are provided to a grantee and subsequently passed through to another organization which actually performs the programs for which the funds are provided. There is no measurable involvement by the grantee in the use or administration of funds. This example illustrates such a situation. Since these funds (which are recorded as a cost in the records of the department) do not reflect the expenditure of resources, they are excluded from the computation. However, if the grantee does incur a significant amount of costs in administering the grant, then it should be assessed for its equitable share of indirect costs. This column would normally be used by states only and not by local governments.
- (c) Expenditures not allowable. This amount represents costs of capital expenditures and other costs which are unallowable under OMB Circular A-87. Unallowable costs must be allocated their share of indirect costs if they either generated or benefited from the indirect costs. In this example, this is not the case.
- (d) Equipment Use Costs (or Depreciation). These costs do not appear on most state or local government financial statements. This amount represents the Use Allowance on the portion of equipment benefitting federal programs that were purchased with the grantee's own funds.
- (e) This amount represents the allocation base (modified total direct costs) used to calculate the indirect cost rate.
- (f) Central Service Cost Allocation Plan Costs. The amounts shown must agree with the approved Central Service Cost Allocation Plan.

## **EXHIBIT B**

### **Multiple Allocation Base Method**

## **Exhibit B**

### **MULTIPLE ALLOCATION BASE METHOD [Unrestricted Indirect Cost Rate]**

The Multiple Allocation Base Method is used whenever a grantee agency's indirect costs benefit its major functions in varying degrees. Such costs shall be accumulated into separate cost groupings. Each grouping shall then be allocated individually to benefited functions by means of a base which best measures the relative benefits.

The cost groupings should be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping should constitute a pool of expenses that are of like character in terms of the functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The number of separate groupings should be held within practical limits, taking into consideration the materiality of the amounts involved and the degree of precision needed.

Actual conditions must be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefited functions. When an allocation can be made by assignment of a cost grouping directly to the function benefited, the allocation shall be made in that manner. When the expenses in a grouping are more general in nature, the allocation should be made through the use of a selected base which produces results that are equitable to both the federal government and the grantee department or agency. In general, any cost element or related factor associated with the agency's activities is potentially adaptable for use as an allocation base provided that: (1) it can readily be expressed in terms of dollars or other quantitative measures (total direct costs, direct salaries and wages, staff hours applied, square feet used, hours of usage, number of documents processed, population served, and the like); and (2) it is common to the benefited functions during the base period.

Except where a special indirect cost rate(s) is required in accordance with 34 CFR 76.564 - 76.569, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual federal financial assistance programs included in that function by use of a single indirect cost rate.

The distribution base used in computing the indirect cost rate for each function may be, (1) total direct costs (excluding capital expenditures and other distorting items, such as flow-through funds, the portion of each subaward in excess of \$25,000, etc.), (2) direct salaries and wages, or (3) another base which results in an equitable distribution. An indirect cost rate should be developed for each separate indirect cost pool developed. The rate in each case should be stated as the percentage relationship between the particular indirect cost pool and the distribution base identified with that pool.

**EXHIBIT B**  
**SAMPLE - EDUCATION DEPARTMENT/AGENCY**  
**INDIRECT COST RATE PROPOSAL - MULTIPLE RATE METHOD**  
**FOR THE YEAR ENDED JUNE 30, 199X**  
**[UNRESTRICTED RATE]**

Allocation Base (a)	Total Indirect Costs (b)	Elementary & Secondary Education	Adult Education	Vocational Education	Food Services	Pupil Transportation
<b>CENTRAL SERVICES</b>						
Personnel	\$275,000	\$100,000	\$75,000	\$75,000	\$15,000	\$10,000
Accounting	250,000	115,000	60,000	60,000	10,000	5,000
Purchasing	150,000	90,000	20,000	20,000	10,000	10,000
Audit	125,000	75,000	20,000	15,000	10,000	5,000
Space	200,000	120,000	20,000	30,000	20,000	10,000
<b>Subtotal</b>	<b>\$1,000,000</b>	<b>\$500,000</b>	<b>\$195,000</b>	<b>\$200,000</b>	<b>\$65,000</b>	<b>\$40,000</b>
<b>DEPARTMENTAL INDIRECT COSTS</b>						
Office of Secretary	\$275,000	\$100,000	\$75,000	\$75,000	\$15,000	\$10,000
Legal Counsel	125,000	55,000	35,000	15,000	5,000	15,000
Comptroller	475,000	218,500	114,000	114,000	19,000	9,500
Personnel	525,000	189,000	141,750	141,750	31,500	21,000
Computer Services	1,000,000	450,000	275,000	150,000	75,000	50,000
Property Management	450,000	226,000	100,000	50,000	25,000	50,000
Equipment Use Allowance	225,000	80,000	45,000	45,000	20,000	40,000
Building Use Allowance	675,000	345,000	57,500	86,250	57,500	28,750
<b>Subtotal</b>	<b>\$3,660,000</b>	<b>\$1,662,500</b>	<b>\$838,250</b>	<b>\$677,000</b>	<b>\$248,000</b>	<b>\$224,250</b>
<b>DIVISIONAL INDIRECT COSTS</b>						
The proposed divisional indirect costs must be identified by line item and reconciled to supporting financial records.						
Total Indirect Costs	\$2,350,000	\$1,107,500	\$521,750	\$423,000	\$142,000	\$155,750
<b>MODIFIED TOTAL DIRECT COSTS</b>	<b>\$7,000,000</b>	<b>\$3,270,000</b>	<b>\$1,555,000</b>	<b>\$1,300,000</b>	<b>\$455,000</b>	<b>\$420,000</b>
<b>INDIRECT COST RATES</b>	<b>\$75,000,000</b>	<b>\$25,000,000</b>	<b>\$17,000,000</b>	<b>\$16,000,000</b>	<b>\$10,000,000</b>	<b>\$7,000,000</b>

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34 NOTE: THE COSTS INCLUDED IN THIS EXHIBIT ARE FOR ILLUSTRATIVE PURPOSES ONLY.

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## **Exhibit B - Multiple Allocation Base Method**

### **Notes to Exhibit B**

- (a) The allocation bases used were selected as reasonable and applicable under the circumstances. Other basis could be just as acceptable if they represented a fair measure of cost generation or cost benefit. Nevertheless, allocation methods should not go beyond what is required by OMB Circular A-87 and U.S. Department of Education regulations (34 CFR). **Schedules supporting each allocation are required to be submitted with each indirect cost rate proposal.**
- (b) The costs in this column must be reconciled to official financial statements. In this illustration, it is assumed that all costs incurred are allowable and relevant in accordance with OMB Circular A-87. To the extent that unallowable or excludable costs are included therein, a separate column should be added to the schedule to show the amounts and adjustments made.

## **EXHIBIT C**

### **Unrestricted and Restricted (Special) Indirect Cost Rates**

## **Exhibit C**

### **Unrestricted and Restricted (Special) Indirect Cost Rates**

**Special Indirect Cost Rates** may be required when a single indirect cost rate for all activities of a grantee department or agency, or for each major function of the agency, may not be appropriate. It may not take into account those different factors which may substantially affect the indirect costs applicable to a particular program or group of programs. The factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the organizational arrangements used or any combination thereof. When a particular program(s) is performed in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to that program(s). The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used, provided that: (1) the rate differs significantly from the rate which would have been developed under the simplified or multiple allocation base method and (2) the programs to which the rate would apply are material in amount.

An example is a major activity or function that is performed at a site other than the recipient's main office. Here an off-site rate, where occupancy costs are removed from the pool may be appropriate.

Also, **Restricted Indirect Cost Rates** must be determined when ED grant programs listed in Appendix IV are administered by the governmental unit. These programs have a statutory requirement prohibiting the use of federal funds to supplant non-federal funds. In such cases, the unrestricted rate must be calculated first then converted to the restricted rate. As shown in the sample format, this is accomplished by removing certain items from the indirect cost pool and placing them in the direct cost base.

**EXHIBIT C**  
**SAMPLE - EDUCATION DEPARTMENT/AGENCY**  
**UNRESTRICTED AND RESTRICTED INDIRECT COST RATE PROPOSAL**  
**FOR YEAR ENDED JUNE 30, 199X**

	UNRESTRICTED RATE			RESTRICTED RATE			Notes				
	Total Costs (a)	Excluded (b)	Unallowable (b)	Indirect	Direct	Total Costs	Excluded (b)	Unallowable (b)	Indirect	Direct	
<b>DIVISION/BUREAU:</b>											
Handicapped Education	\$13,000,000	\$10,500,000	\$	\$	\$	\$13,000,000	\$10,500,000	\$	\$	\$2,500,000	
Elementary Education	14,900,000	14,200,000				700,000	14,200,000			700,000	
Vocational Education	7,800,000	6,700,000				1,100,000	6,700,000			1,100,000	
Library Services	2,600,000	1,800,000				800,000	2,600,000			800,000	
Special Education	9,400,000	7,700,000				1,700,000	9,400,000			1,700,000	
Evaluation Services	2,300,000					2,300,000	2,300,000			2,300,000	
Student Services	4,300,000	100,000				4,200,000	4,200,000			4,200,000	
Other Direct	6,200,000	5,600,000				600,000	6,200,000			600,000	
<b>DEPARTMENTAL:</b>											
Superintendent's Office	300,000	10,000				290,000	300,000	10,000		290,000	
Legal Services	250,000	5,000				245,000	250,000	5,000		245,000	
Fiscal Services	280,000	6,000				274,000	280,000	6,000		274,000	
Personnel Services	370,000	11,000				359,000	370,000	11,000		359,000	
Public Relations	80,000					30,000	80,000			30,000	
Occupancy	300,000					300,000	300,000			300,000	
Equipment Use	60,000	12,000				48,000	60,000	12,000		48,000	
Procurement Office	210,000	7,000				203,000	210,000	7,000		203,000	
Policy & Budget Office	140,000	4,000				136,000	140,000	4,000		136,000	
<b>Total Departmental and Base</b>	<b>\$62,490,000</b>	<b>\$46,655,000</b>	<b>\$30,000</b>	<b>\$1,885,000</b>	<b>\$13,900,000</b>	<b>\$62,490,000</b>	<b>\$46,655,000</b>	<b>\$1,145,000</b>	<b>\$14,170,000</b>		
<b>State-Wide Costs</b>	<b>120,000</b>					<b>120,000</b>	<b>120,000</b>	<b>12,000</b>	<b>108,000</b>		
<b>Subtotals</b>	<b>\$62,610,000</b>	<b>\$46,655,000</b>	<b>\$30,000</b>	<b>\$1,885,000</b>	<b>\$13,900,000</b>	<b>\$62,610,000</b>	<b>\$46,667,000</b>	<b>\$1,253,000</b>	<b>\$14,170,000</b>		
<b>Unallowable Costs</b>						<b>50,000</b>	<b>50,000</b>				
<b>Totals</b>	<b>\$62,610,000</b>	<b>\$46,655,000</b>	<b>\$30</b>	<b>\$1,885,000</b>	<b>\$13,900,000</b>	<b>\$62,610,000</b>	<b>\$46,667,000</b>	<b>\$30</b>	<b>\$1,253,000</b>	<b>\$14,169,000</b>	
										<b>RATE = \$1,253,000/\$14,169,000 = 8.5%</b>	

**NOTES:**

- (a) Should equal totals for each cost category in state education agency's official financial report. Differences should be reconciled and explained.
- (b) All flow-through, equipment purchase, and alteration and renovation costs are excluded.
- (c) Unallowable costs which generate, or benefit from, the SEA's indirect costs are placed in the base.
- (d) Costs of the Superintendent (and Deputy, if applicable) are direct costs for purposes of calculating Restricted Rate (34 CFR 76.565 (b) and (c) 34 CFR 76.567 (a)). These components report to the Superintendent (or Deputy Superintendent). Therefore, they are "Heads of Components" (34 CFR 76.565 (d)(1)), and their salaries and expenses are placed in the base (34 CFR 76.567 (a)).
- (e) Only allowable Public Relations costs are those necessary to conduct general liaison with news media and government public relations officers (OMB Circular A-87, Attachment B (d)(3)). Here recipient had incurred unallowable costs to promote itself and other general public relations activities (OMB Circular A-87, Attachment B (2)(e)).
- (f) For Restricted Rate, only allowable Occupancy costs are those associated with "organization-wide" (e.g. allowable Restricted) indirect activities. Here, space study showed that such activities occupied 10% of total work area space.
- (g) Recipient elects Use Allowance in lieu of Depreciation. Use Allowance allocable to equipment purchased with federal funds has been eliminated (OMB Circular A-87, Attachment B (15)(c)(2) and (3)).
- (h) The portion of state-wide costs related to Occupancy has been deleted from the Restricted Rate pool.

THE ABOVE SAMPLE IS FOR GUIDANCE PURPOSES ONLY AND IS NOT INTENDED TO PRESCRIBE METHODS OF ACCOUNTING.

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## **EXHIBIT D**

### **Computation of Fixed Indirect Cost Rates with Carry-Forward Provision**

## **Exhibit D**

### **Computation of Fixed Indirect Cost Rates with Carry-Forward Provision**

A fixed rate with carry-forward provision has characteristics of both a provisional and a predetermined rate. A rate is computed and fixed for a specified future period based on an estimate of that period's level of operations. However, when the actual costs of that period become known, the difference between the estimated costs and the actual costs is carried forward as an adjustment to a subsequent period for which a rate is established. The adjustment cannot be made in the fiscal period immediately following because the fixed rate for that period will already have been determined. An adjustment generally will be carried-forward to the second or third fiscal period following the period being adjusted. A fixed rate should be selected that closely approximate the actual rate expected to be incurred. An accurate forecast will confine carry-forward amounts to minimal differences. The computation of a fixed rate with carry-forward at the department/agency level should include any provisions made for central service costs.

The fixed rate with a carry-forward cannot be used where there is only short or widely-fluctuating federal funding, or where there is a likelihood of organizational change, or a fluctuating level of operation which would make projection of costs unrealistic.

A sample of the carry-forward adjustment and computation of unrestricted and restricted fixed indirect cost rates follows.

**SAMPLE EDUCATION DEPARTMENT/AGENCY  
COMPUTATION FOR FIXED INDIRECT COST RATES WITH CARRY-FORWARD PROVISION  
FOR THE YEAR ENDING JUNE 30, 1987**

**GIVEN:**

- (1) Below, Actual Costs for Fiscal Year 1986.
- (2) Fiscal Year 1983 Actual Costs Were Used to Calculate Fixed Rates for 1985.

		Unrestricted		Restricted	
Departmental		\$1,760,000		\$1,210,000	
Central Services		135,000		117,000	
Carry-Forward		(67,800)		(57,000)	
Total Pool		<u>\$1,828,000</u>		<u>\$1,270,000</u>	
Base		\$13,200,000		\$13,750,000	
Rate		<u>13.8%</u>		<u>9.2%</u>	

**CALCULATIONS:**

		1. UNRESTRICTED RATE		2. RESTRICTED RATE	
		Fiscal Year 1986		Fiscal Year 1987	
Rate		<u>13.8%</u>		<u>9.2%</u>	
Base		\$13,200,000		\$13,750,000	
Departmental		\$1,760,000		\$1,210,000	
Central Services		135,000		117,000	
Carry-Forward		(67,800)		(57,000)	
Total Pool		<u>\$1,828,000</u>		<u>\$1,270,000</u>	
Actual Costs:					
Base		\$13,850,000		Base	
Departmental		\$1,885,000		Departmental	
Central Services		135,000		117,000	
Carry-Forward		(67,800)		(57,000)	
Total Pool		<u>\$1,863,000</u>		<u>\$1,205,000</u>	
Carry-Forward Computation:					
Actual Base		\$13,850,000		Actual Base	
Fixed Rate		X 13.8%		Fixed Rate	
Indirect Costs Billed				Indirect Costs Billed	
Actual Indirect Costs				Actual Indirect Costs	
Over or (Under) Recovery				Over or (Under) Recovery	
				\$ 147,880	

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## **EXHIBIT E**

### **Reconciliation of Indirect Cost Rate Proposal**

## **Exhibit E**

### **Reconciliation of Indirect Cost Rate Proposal**

A fundamental step in developing the indirect cost proposal review involves the reconciliation of actual cost data to the annual financial report for the organization. The process goes beyond merely comparing total cost to aggregate financial detail. Because the indirect cost review measures trends in individual indirect cost and direct cost categories, the organization's indirect cost proposal must reconcile to the organization's audited financial statement by cost element. Further, function costs must be aligned to a current organizational chart to ensure all organizational activities are accounted for. An illustration of a reconciliation follows. The organization is expected to provide support or explanation for any substantive variances.

**EXHIBIT E**  
**RECONCILIATION OF INDIRECT COST RATE PROPOSAL NO. 96-555 TO FINANCIAL REPORT**

Account No.	Cost Center	PER EXPENDITURE REPORT				PER PROPOSAL				Differences ((5) less (9))
		(1) Salaries & Employee Benefits	(2) Supplies & Materials	(3) Capital Outlay	(4) Local Assistance & Special Purpose	(5) Totals (1+2+3+4)	(6) Direct	(7) Indirect	(8) Excluded	
M000	State Board of Education	\$226,000	\$57,500	\$0	\$0	\$323,500	\$323,500	\$0	\$0	\$323,500
M100	Superintendent (or Director's) Office	342,000	98,300	10,200	0	450,500	440,300	10,200	450,500	\$0
M101	Comptroller's Office	213,300	51,900	6,700	0	271,900	0	265,200	6,700	271,900
M102	Personnel Office	405,900	91,700	0	0	497,600	0	497,600	0	497,600
M103	Procurement, Policy & Procedures	216,600	48,900	0	0	265,500	0	265,500	0	265,500
M104	Legal Office	234,700	65,000	9,900	0	309,600	0	299,700	9,900	309,600
M105	Data Systems & Services	444,400	76,200	78,900	0	599,500	0	520,600	78,900	599,500
M106	Public Affairs & Information	306,600	83,700	10,800	0	401,100	390,300	0	10,800	401,100
M107	Internal & External Audits	261,900	69,300	6,570	0	337,770	0	331,200	6,570	337,770
S100	Division of Instruction & Curriculum	894,300	384,000	7,860	0	1,286,160	1,278,300	0	7,860	1,286,160
S101	Adult Education Division	1,530,000	342,000	6,770	0	12,000,000	13,818,770	1,872,000	0	12,006,770
S102	Vocational Education Division	1,089,600	450,800	5,760	0	9,346,160	9,346,160	0	7,805,760	9,346,160
S103	Special Education Division	1,188,000	423,900	8,760	0	14,800,000	16,420,660	1,611,900	0	16,420,660
S104	School Food Services Division	810,000	567,000	9,360	0	17,100,000	18,486,360	1,377,000	0	18,486,360
S105	Teacher Education & Certification	446,000	192,900	0	0	638,900	638,900	0	0	638,900
S106	Pupil Transportation	483,000	290,100	0	0	9,810,000	10,493,100	683,100	0	10,493,100
S107	Special Services Division	727,800	239,400	6,660	0	6,733,860	967,200	0	5,766,660	6,733,860
S108	Federal & Special Projects Division	457,200	149,400	0	0	20,496,600	20,496,600	0	0	20,496,600
S109	Division of Migrant Education	972,900	429,300	11,700	0	19,890,000	20,496,600	606,600	0	19,890,000
S110	School for the Deaf & Blind	873,900	424,200	21,690	0	31,105,900	31,105,900	1,402,200	0	31,105,900
S111	Assessment & Testing	629,100	447,000	34,200	0	4,788,000	6,107,790	1,298,100	0	4,809,690
S112	Regional Education Service Centers	735,300	221,400	6,840	0	1,110,300	1,076,100	0	34,200	1,110,300
	<b>Totals</b>	<b>\$13,528,500</b>	<b>\$5,114,000</b>	<b>\$242,670</b>	<b>\$0</b>	<b>\$93,640,000</b>	<b>\$112,525,170</b>	<b>\$2,620,100</b>	<b>\$93,882,400</b>	<b>\$112,525,170</b>
	Subtotal Salaries & Benefits	13,528,500								
	Subtotal Operating	5,114,000								
	<b>Financial Report Direct and Indirect</b>	<b>\$18,642,500</b>								
	Proposal Indirect	2,620,100								
	Proposal Direct	16,022,400								
	<b>Proposal Direct and Indirect</b>	<b>\$18,642,500</b>								

55  
 Subtotal Salaries & Benefits  
 Subtotal Operating

Financial Report Direct and Indirect  
 Proposal Indirect  
 Proposal Direct  
 Proposal Direct and Indirect

\$18,642,500  
 \$2,620,100  
 16,022,400  
 \$18,642,500

\$18,642,500  
 \$2,620,100  
 16,022,400  
 \$18,642,500

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## **SECTION IV**

### **STATE EDUCATION AGENCY RESPONSIBILITIES**

## **SECTION IV**

### **STATE AND LOCAL AGENCY RESPONSIBILITIES**

#### **A. General**

State and local agencies that are receiving federal funds are required to comply with the provisions of OMB Circular A-87 and Education Department General Administrative Regulations (EDGAR) in order to be reimbursed for indirect costs. State agencies are responsible for approving indirect cost rates for local government agencies, if ED has approved their procedures and processed an official delegation for local education agency oversight. In addition, grantee agencies are required to ensure that subcontracting agencies or subrecipients also comply with the appropriate OMB Circulars and federal regulations.

#### **B. Procedures**

EDGAR at 34 CFR 561 (b) provides the flexibility for the ED to delegate the authority for local education agency (LEA) indirect cost rate determinations to the designated state education agency (SEA). ED must first approve the LEA indirect cost plan to ensure that the SEA methodology and procedures for indirect cost oversight are satisfactory. The official delegation is reviewed by ED every five years. A sample narrative description of an LEA methodology indirect cost proposal format are included in Appendices VI and VII. A sample official SEA for indirect cost oversight delegation is included as Appendix VIII.

#### **C. Subrecipients other than state and local grantees**

Subrecipients who are not state and local governments need indirect cost rates also before claiming indirect cost reimbursement. In financial relationships where the subrecipient receives little or no funding directly from any federal agency and the SEA is their primary funding source, the SEA is responsible for establishing the subrecipients indirect cost rate using the same methodology that was approved for LEA rate determinations. **For administrative expediency, the subrecipient and SEA may at their option elect to use a rate under the award that represents the average restricted rate approved for use by LEAs during that award period.**

## **SECTION V**

## **OTHER GUIDANCE**

## SECTION V

### OTHER GUIDANCE

#### A. Common Indirect Cost Problems

The following are the most common problems that state and local governments encounter when developing indirect cost proposals:

- o ***Accounting information.*** The most common problem grantees encounter in preparing an indirect cost proposal is the lack of cost information and data about their organization. Many find any method beyond the simplified method difficult to construct. Good records are an essential ingredient in the indirect cost process.
- o ***Lack of attention in planning.*** Another problem is the lack of time and resources that grantees are able (or willing) to devote to preparing a proposal. Preparing an indirect cost proposal need not be a major undertaking at most organizations, but it does take forethought and attention.
- o ***Controlling costs.*** Grantor agencies are cautious about and critical of organizations that show a tendency toward waste, luxury and extravagance. Organizations should take care when incurring indirect costs.
- o ***Recovering indirect costs once the rate is approved.*** Having an approved indirect cost rate does nothing for a grantee unless it can use that rate to recover indirect costs. Many funding agencies are reluctant to include all (or any) indirect costs in their awards. The grantee may need to make some hard choices in such instances. However, it is important for grantees to remember that indirect costs are real and necessary to grantee operations and they have to be recovered in some way.
- o ***The psychological barrier.*** There is an unfounded fear that indirect costs are extremely complex and unfathomable except to high-priced accounting specialists. On the contrary, the indirect cost process is a logical, step-by-step exercise that most grantees can perform with some guidance and planning.

## **B. Common Review Questions**

There are numerous issues raised during the rate negotiation process. Some questions most likely to be asked are listed below. By keeping these questions in mind when preparing the indirect cost rate, grantees should be able to anticipate the type of review that will be conducted and possible sticking points in negotiations. This should help in preparing documentation to justify the approaches taken.

### **Preliminary**

- o Is a rate needed because awards are present or sought that permit charging of indirect costs?
- o Is the rate negotiation the first between this grantee with the cognizant agency?
- o Is coordination with other federal agencies needed?
- o Are all supporting data and documentation provided (e.g., audited financial statements, total direct costs incurred under federal grants, salaries and wages incurred under federal grants and organizational charts)?
- o Are the audited financial statements submitted in support of the proposal unqualified?
- o Is the proposal properly reconciled and cross-referenced to the financial statements?
- o Is the organization financially capable of performing its federal awards?
- o Is the organization affiliated with another organization?
- o If prior proposals have been submitted, do they (and the work papers prepared by the reviewer) show substantial adjustments from prior years?
- o Did the organization comply with prior agreements?
- o Is an off-site or special rate needed?
- o What audits (federal and non-federal) has the organization had?
- o What level of negotiation effort and audit is needed?

### **Cost Allowability**

- o How do the proposed costs compare to prior years?
- o Do the proposed costs benefit federal grants and contracts?
- o Have contributions (as opposed to costs) been eliminated from the indirect cost pool?
- o Are there any applicable expense offsets?
- o Does the indirect cost pool contain any unallowable expenses (e.g., capital expenditures, fundraising, public relations, advertising, bad debts, contributions and donations, entertainment, fines and penalties, or losses from other awards)?
- o Does the cost proposal contain certain costs considered vulnerable to mischarging by the organization? Are these properly treated?
- o Are costs included in the proposal consistently treated as indirect costs?

### **Review of Allocation Bases**

- o Are the allocation bases that are used required or suggested by applicable cost principles or federal agency guides on preparing indirect cost proposals? If not, what factors justify deviation?
- o Do proposed bases result in equitable distribution of indirect costs?
- o Do proposed bases include all activities (e.g., general fund, noninstructional services, donated services and special revenue fund) that benefit from the indirect costs that are allocated?
- o Are the data used for allocation purposes (e.g., square footage, number of personnel, salaries) current?

### **Concluding Steps**

- o Are mathematical calculations accurate?
- o Are there any anticipated changes in the level of the organization's activities, its structure or accounting system, that should be taken into account in negotiating a rate?
- o Which type of rate (provisional/final, predetermined or fixed with carry-forward) should be used?
- o Should an advance agreement covering future negotiations be established?

### **C. Time Distribution**

The provisions of the new OMB Circular A-87 clarified documentation requirements to establish consistency in providing a clear audit trail for salaries and wages, particularly when labor is split across cost centers and charged to different fund sources. In many respects, the revised OMB Circular A-87 simplifies the record keeping process while providing the state and local unit of government with flexibility on selecting different options for recording personnel activity distributions. The alternatives are:

#### **(1) Actual Time**

An after-the-fact recording of the actual time spent by each employee on various activities. The after-the-fact documentation can be done at the end of each day, week or month. The Sample Time Sheet shown in paragraph (4) below satisfies the OMB documentation standard. This Time Sheet can also be adapted to Lotus software for an automated accumulation of data.

#### **(2) Budget Estimates**

Salary cost distribution can be charged based on estimates so long as charges to federal programs based on estimates are adjusted quarterly to reflect actual effort or other changed circumstances.

#### **(3) Substitute Systems**

A substitute system for allocating salary and wages can be used in place of activity reports. OMB Circular A-87 advises that such substitute systems can include random moment sampling, case counts or other formats that accurately measure employee effort. OMB encourages the cognizant federal agency and state and local units of government to work together in testing different mechanisms for charging costs. In this regard, ED developed the following substitute system methodology that borrows from the characteristics of both the budget estimate and sampling approach. Under these procedures, a state and local unit of government may assign estimated percentages of each employee's salary to various accounts, based on completed personnel activity reports from an immediately preceding period. Specifically, this substitute system establishes a record keeping cycle based on the state's accounting period which runs from July 1 to June 30. It is also based on the premise that there is even workload over the full 12-month period. More frequent reconciliations may be necessary to address circumstances that result in substantial payroll changes (e.g., rescinded programs and reorganizations). The system provided here uses July as the base month for starting the time distribution system. This is only an example. We recommend that the state and local unit of government choose a starting month that most accurately reflects your annual average labor cost experience.

- (1) PARs for each employee will be kept by the state or local governmental unit for the full month of July to account for 100% of the activity for which employees are compensated. The PARs will reflect the actual percentage of activity expended for direct, indirect, cost sharing, and all other organizational activities. The labor distribution reports for July can be used to support effort distribution and charges for incurred costs in July, as well provide the basis for employee salary and fringe benefit allocations for August, September and October.
- (2) In November, the state or local unit of government will repeat the actual effort recording and reporting exercise described in step (1). The November PARs will be used to make comparisons with the budgeted effort distribution made in August, September and October and adjustments if necessary, and project salary and fringe benefit allocations for December, January and February. These PARs can also be used to support effort and labor costs incurred in November.
- (3) In March, another actual record keeping procedure will be performed by the state or local governmental unit to (a) support effort distribution and labor costs incurred in March, (b) compare and adjust the budgeted salary distributions made in December, January and February and (c) develop new estimates for budgeted effort for the months of April, May and June.
- (4) Actual record keeping will be done once more in July to support incurred labor cost allocations for that month and then using that information to compare and adjust the budgeted effort distribution made in April, May and June. Further, the July PARs start another round of labor distribution estimates in the new fiscal year.
- (5) If the average level of adjustments resulting from the comparisons of actual costs to budgeted distributions in November, March and July are less than 10%, the state and local unit of government may negotiate less frequent PAR cycle with ED. Those employees who work 100% on one federal cost objective must be excluded from consideration when the variance adjustments are averaged.
- (6) Written policies and procedures are essential to implementing an effective labor distribution system. Therefore, the state and local unit of government should develop instructions for (a) the completion of PARs, (b) the review and approval cycle that is required, (c) the handling of completed forms, and (d) the internal review process that will be established to ensure compliance. Generally, this information should be in sufficient detail to permit an understanding of how this system will operate from the point of labor is expended, to the point it is recorded in the accounting records and charged to federal awards.

## Sample Personnel Activity Report

Period Ending (1) \_\_\_\_\_

Fiscal Year \_\_\_\_\_

Name \_\_\_\_\_

Division or Department \_\_\_\_\_

<u>Accounting Description</u>	<u>Account Number</u>	<u>Percent of Effort</u>
Project: A		30
B		30
C		30
Administration		5
Cost Sharing		5
	Total Effort	100%

I hereby certify that this report is an after-the-fact determination of actual effort expended for the period indicated and I have full knowledge of 100% of these activities.

Employee	Date	(2)	Responsible Official	Date
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(1) - Report must be prepared at least monthly and coincide with one or more pay periods.

(2) - Supervisory official having first hand knowledge of the activity performed by the employee.

## Sample Time Sheet

Name \_\_\_\_\_  
 Position \_\_\_\_\_  
 Department \_\_\_\_\_  
 Pay Period Ending \_\_\_\_\_

Account No.	100	200	300	400	500	600	700	800	Totals
Account Title	Indirect	ECIA (Federal)	State (be Specific)	Other (Specify)	Annual Leave	Sick Leave	Holiday Leave	Other Leave (Specify)	
Mon.	0	0	0	0	0	0	0	0	0
Tues.	0	7	1	0	0	0	0	0	8
Wed.	0	8	0	0	0	0	0	0	8
Thurs.	0	6	2	0	0	0	0	0	8
Fri.	0	2	2	0	4	0	0	0	8
Mon.	2	5	1	0	0	0	0	0	8
Tues.	1	6	1	0	0	0	0	0	8
Wed.	0	3	5	0	0	0	0	0	8
Thurs.	0	6	0	2	0	0	0	0	8
Fri.	1	6	1	0	0	0	0	0	8
<b>Totals</b>	<b>4</b>	<b>49</b>	<b>13</b>	<b>2</b>	<b>4</b>	<b>0</b>	<b>8</b>	<b>0</b>	<b>80</b>
Percent of Total*	5.00%	61.25%	16.25%	2.50%	5.00%	0.00%	10.00%	0.00%	100.00%
Bi-Weekly Salary	1,700.00	1,700.00	1,700.00	1,700.00	1,700.00	1,700.00	1,700.00	1,700.00	
Amount Charged	<b>85.00</b>	<b>1,041.25</b>	<b>276.25</b>	<b>42.50</b>	<b>85.00</b>	<b>0.00</b>	<b>170.00</b>	<b>0.00</b>	<b>1,700.00</b>

I certify that this report represents a true recording of effort expended for the period indicated and that I have full knowledge of those activities.

Signature of Employee \_\_\_\_\_ Date \_\_\_\_\_ Responsible Official \_\_\_\_\_ Date \_\_\_\_\_

\* Total Hours for Activity divided by Total Paid Hours for Account No. 100, 4 Hours worked divided by 80 hours = 5.00% charged.

#### **D. Administration Limits and Indirect Cost Claims**

Various education funding instruments have statutory or regulatory limitations on the costs of "administration." (The costs of administration are those portions of reasonable, necessary and allowable costs associated with the overall project management and administration and which are not directly related to the provision of services to participants or otherwise allocable to the program cost objectives/categories). These costs can be both personnel and non-personnel and both direct and indirect. Therefore, the statutory or regulatory limitation applies to the combined claims for indirect costs and direct administration costs. Generally, direct administration costs differ from indirect charges in that the latter are considered organization-wide costs. This means costs which are service oriented that benefit the entire organization in a business sense systemically.

Examples of direct administration are salaries, benefits, and other expenses of the recipient or subrecipient's staff who perform the following functions:

- o overall program management, program coordination, and office management functions, including the salaries and related costs of the executive director, project director, project evaluator when directly allocated;
- o preparing program plans, budgets schedules, and related amendments;
- o monitoring of programs, projects, subrecipients and related systems and processes;
- o developing systems and procedures, including management information systems, for assuring compliance with program requirements;
- o preparing reports and other documents related to the program requirements;
- o evaluating program results against stated objectives; and
- o performing divisional level administrative services such as program specific accounting, auditing or legal activities.

Examples of non-labor costs for direct administration include:

- o costs for goods and services required for administration of the program, including such goods and services as the rental or purchase of equipment, utilities, office supplies, postage, and rental and maintenance of office space; and
- o travel costs incurred for official business in carrying out program management at administrative activities.

### **How administrative cost limitations affect indirect cost reimbursement?**

Assuming a 15% limitation of total costs, the effect on the indirect cost reimbursement is shown below.

Grant/Contract Funds Available	<u>\$1,000,000</u>
Administrative Cost Limitation at 15%	<u>\$ 150,000</u>
Direct Program Administrative Cost Incurred	\$ 112,500
Indirect Cost Reimbursement	<u>37,500</u> (1)
	<u>\$ 150,000</u>

### **COMPUTATION OF ALLOCABLE INDIRECT COST:**

Modified Direct Total Costs (MDTC)  
Incurred on Grant/Contract (including Costs  
for Direct Administration) \$ 450,000

Negotiated Indirect Cost at a  
Rate of 10% of MDTC \$ 45,000 (1)

(1) Limited to reimbursement of \$37,500 due to overall administrative cost limitation of \$150,000 of which \$112,500 was expended for direct program administrative costs.

## **SECTION VI**

### **QUESTIONS AND ANSWERS**

## SECTION VI

### QUESTIONS AND ANSWERS

#### **Application of Principles:**

**Q. Is OMB Circular A-87 mandatory for use by both states and local governments?**

**A.** Yes. Paragraph 3, Section A, Attachment A of the Circular states that these principles will be applied by all federal agencies in determining costs incurred by governmental units under federal grants, cost reimbursement type contracts, and cooperative agreements (including subgrants and subcontracts) except those with (1) publicly-financed educational institutions subject to OMB Circular A-21, and (2) programs administered by publicly-owned hospitals and other providers of medical care that are subject to requirements promulgated by the sponsoring federal agencies.

**Q. OMB Circular A-87 states that it does not apply to grants and contracts with (1) publicly-financed educational institutions subject to OMB Circular A-21, and (2) programs administered by publicly-owned hospitals and other providers of medical care that are subject to requirements promulgated by the sponsoring federal agencies. What is the intent of this statement and how does it affect the reimbursement of costs?**

**A.** Federal cost principles are designed to be compatible with the organizational structure, accounting systems and programs conducted by specific types of organizations which perform federal grants and contracts. OMB Circular A-87 was designed to be compatible with the type of operations conducted by state and local government. The organization and operations of colleges and universities differ markedly from that of state and local governments and, hence, there are special cost principles for them (OMB Circular A-21). These principles recognize state and local central service costs and departmental indirect costs allocable under the procedures of OMB Circular A-87.

**Q. Will the indirect costs arrived at by the application of the indirect cost rate percentage be reimbursed to state and local governments?**

**A.** The indirect costs which are determined to be associated with federal programs in accordance with the procedures in OMB Circular A-87 will be recognized as part of the total cost of the federal projects, except where restricted or prohibited by law. The extent to which such costs are reimbursed is a matter for determination between the federal awarding agency and the recipient state or local unit of government.

### **Federal Cognizance:**

**Q. Can another federal agency question the costs included in a central service cost allocation plan submitted to and approved by a cognizant agency?**

**A.** Cognizant federal agencies will coordinate the approval of central service plans with the other federal agencies affected. Accordingly, federal agencies will accept, as part of the costs of a particular state or local government agency, those costs represented as central service costs, provided they are in accord with the amounts set out in the negotiation agreement signed by the representatives of the state or local government and the cognizant federal agency. The exception for ED would be in a restricted rate environment, adjusting Occupancy and Maintenance cost that were approved in the State Wide Cost Allocation Plan.

**Q. Where can states and local governments receive additional information or clarification on the implementation of OMB Circular A-87?**

**A.** States and local governments should contact the federal agency that has been assigned cognizance for either central service cost allocation plans or individual government department indirect cost proposals.

### **Definitions:**

**Q. To what does the expression "cost allocation plan" refer?**

**A.** A cost allocation plan refers to a document that identifies, accumulates and distributes allowable costs to grants and contracts and identifies the procedures used in making such distribution. It refers to both the central service cost allocation plan which is used to allocate the costs of central government services to benefiting government departments and the indirect cost proposals of those departments or units performing grants and contracts.

**Q. What is an indirect cost rate?**

**A.** An indirect cost rate is the ratio of an organization's indirect costs to some element of its direct costs, e.g., direct salaries and wages. Once determined, the rate is used to compute grantee indirect cost entitlement. The entitlement is accomplished by multiplying the indirect cost rate by the direct salaries and wages charged to a grant or contract. An indirect cost rate is the net product of an indirect cost rate proposal.

### **Preparation and Use of Plans:**

**Q. Who is responsible for the preparation of state and local central service cost allocation plans and indirect cost proposals?**

- A. It is the responsibility of each state and local government to prepare timely central service cost allocation plans and indirect cost proposals where indirect cost reimbursement is sought.
- Q. Must the indirect cost proposal or the central service cost allocation plan be prepared centrally for each state or local department performing under federal grant programs?
- A. There is no requirement that an indirect cost proposal be prepared by any designated state or local government organization. Proposals may be prepared by each of the government departments performing under federal grants or they may be prepared in a central office. However, while the state or local central service cost allocation plan need not be prepared centrally, it must be prepared as a single document.
- Q. How will a central service plan be used?
- A. The central service plan is used to distribute allowable central service costs to each of the individual government departments benefited, in order that they might include them in their indirect cost proposal.

**Specific Items of Cost:**

- Q. How can a grantee distinguish between a direct cost and an indirect cost?
- A. There is no universal rule for classifying costs as direct or indirect. Generally speaking, a direct cost is one that is incurred specifically for one activity. Indirect costs are of a more general nature and are incurred for the benefit of several activities. Consequently, some allocation technique must be used to distribute these indirect costs to the several direct functions benefited. Once a grantee makes an election and treats a given cost as direct or indirect it must apply that treatment consistently and may not change during the fiscal year.
- Q. Some grant programs are awarded to the Office of the Governor of a state, to the Chief Executive of a political subdivision, the County Supervisor, City Council, School Board or other similar type of body. Are these grants precluded from covering indirect costs under the Circular?
- A. The general expenses required to carry out the overall responsibilities of these officers are unallowable. Attachment B, Section 23 of the Circular identifies them as general government expenses, and therefore an unallowable cost. However, if special identifiable expenses were incurred to satisfy a federal grant or contract agreement, they would be allowed if they otherwise met the standards of allowability provided in the Circular.

**Q.** Is it permissible to allocate costs (either directly or indirectly) on the basis of revenue or on the basis of funds available under federal grants or contracts?

**A.** No. The allocation of costs by either of these methods is unacceptable. Cost must be allocated on the basis of costs incurred under federal grants or contracts.

### **Restricted Indirect Cost Rates and Supplement not Supplant Requirements**

#### **Background**

Many of the large educational entitlement programs that provide funds to state and local jurisdictions were created by legislative statute which require that the federal funds be used to "supplement and not supplant" on going educational services. This means that state and local agencies have tax revenue or other financial resources of their own to finance the education of their children. The federal government wants to help them achieve greater levels of benefits or services through financial support. Without the "supplement not supplant" provision, state "X" could simply reduce its support of educational service to the extent of the newly available federal funding. This means state "X" could release local funds for other purposes, like tax relief or non-educational projects or other programs. Looking at it another way, without the supplanting prohibition a county could substitute federal money for tax revenue already generated to fund schools. The tax revenue windfall would be available to build other state projects (e.g., sewage treatment plants) and the federal funds would never reach the classroom as intended. To place the supplanting bar in proper context, it is best to equate the education of state citizenry with other basic functions of state government (e.g., utilities like police and fire departments).

**Q. What are Restricted Rates?**

**A.** Restricted rates are special rates established to incorporate these provisions of program legislation that bar supplanting. The restricted indirect cost rate formula is described in the Education Department General Administrative Regulations (EDGAR) AT 34 CFR Parts 75.564 and in more detail at Part 76.564 (See Appendix III). The formula limits the general management costs that can be placed in the indirect cost pool (numerator) and requires a modified total direct cost (MTDC) base (denominator).

**Q. What is the practical effect of the restricted indirect cost rate formula?**

**A.** The indirect cost determination effort for federal financial participation is viewed as a "funneling process." The first step requires the state and local unit of government to segregate the accounting of costs between indirect and direct with full cost reimbursement in mind. However, there is a paring down of the full cost reimbursement concept, when Office of Management and Budget (OMB) Circular A-87 is applied to adjust the indirect cost pool and direct cost base for unallowable costs and distorting cost items that do not benefit from or generate overhead.

The restricted indirect cost rate determination further filter out costs that would be incurred by the state or local unit of government with or without federal influence. EDGAR at 34 CFR part 76.565 explains that in a restricted setting, only costs for the "direction and control" of the grantee may be considered general management costs. Conversely, costs that benefit program operations or relate to organizational units (components) are not general management costs but rather "other direct costs" for rate computation purposes.

Costs associated with activities under organizational units that are not for Department level management also are not accepted as general management costs. Therefore, in a restricted rate setting indirect costs are purged to leave just "organization-wide" general management costs at the grantee level (e.g., bookkeeping, accounting, payroll, auditing, procurement, and personnel). These Departmental level general management costs are refined again to exclude costs associated with the Chief Executive Officers, their immediate officers, and space costs. These costs are then reclassified from indirect to the MTDC base for rate computation purposes.

**Q. Who are the Chief Executive Officers?**

A. There are two types of Chief Executive Officers. One is the Chief Executive Officer of the grantee. This person is the individual who is the head of the executive office at the grantee who exercises overall responsibility for the operation and management of the organization. At the grantee level, the Chief Executive Officer's immediate office includes any Deputies or similar office, along with the immediate support staff of these people. It is important to emphasize here that the Chief Executive Officer of the grantee is not the Governor or member of a Board of a similar elected or appointed body. Expenses for these positions are already unallowable as "costs of general and State and local government." The second type of Executive Officer is the supervisor of a component within the grantee.

**Q. What are Component Costs?**

A. Generally, components are organizational units for both indirect and direct functions that exist one level below the organization unit. Depending on the organization, there may be circumstances where certain direction and control indirect functions would be properly accounted for in the indirect cost pool. However, if the indirect cost functional unit is one level below the Chief Executive Officer of the grantee (or his Deputy or similar position) then the head of the indirect cost component, her/his secretary, and travel and other related office costs should be removed from the indirect cost pool and classified to the MTDC base. In effect, those costs, in that organizational setting, are considered divisional administration applicable to that component with no distinction between indirect and direct functions.

**Q. What does the term organization-wide mean in the restricted indirect cost rate determination?**

**A.** The term organization-wide should be taken to mean those Departmental level direction and control function costs that all recipients of grant funds have in common. The regulations describe accounting, payroll, personnel management as examples of organizational disciplines that every grantee or any organization must have. Often cross cutting educational activities (e.g., Curriculum Development, Pupil Data, Library Services, Evaluation Services, and School Services) are mistaken for indirect cost functions which are not for direction and control of the organization, but rather provide services to schools or students. Those cost centers are more analogous to specialized or program service functions, even if they have system-wide impact. Again, the restricted indirect cost rate determination accepts costs related to maintaining operations as a business concern, but not costs that finance the delivery of services that the state or local unit of government provides as part of its specific mission.

When making a determination as to whether a cost is organization-wide, the state and local unit of government must evaluate whether the activity is more analogous to Departmental "direction and control" overhead, versus administration of program services. The question to be answered is: "Is this cost incurred for general management purposes or does the cost further functions that are the mission of the organization?"

**Q. Will the Government share in costs that are cross cutting but not for direction and control activity if they benefit federal programs?**

**A.** Under restricted indirect cost rate programs, state and local governments are not guaranteed a dollar for dollar reimbursement of all overhead related to federal programs with supplement not supplant provisions. State and local units of government must assume the financial obligation for costs that they normally would not in a normal federal financial relationship. The restricted indirect cost determination accomplishes a marginal distribution of administrative costs required to implement federal assistance.

**Q. Can costs for Divisional Administration under indirect and direct components be billed directly to federal programs?**

**A.** Generally, such costs are the financial obligation of the state and local government. The only exception would be if the ED Grant Award official ruled the costs and the position were specifically required for federal financial participation.

**Q. Space type costs are accepted in a usual indirect cost environment. How are they accounted for in the restricted indirect cost formula?**

A. Occupancy and space maintenance costs as described in EDGAR at 34 CFR Part 76.568 are classified as part of the other cost denominator for the restricted indirect cost rate determination. There are two exceptions. One is if the state and local unit of government can identify that portion of space that supports allowable indirect cost personnel, then those limited costs may be included with allowable general management costs. The second exception would be if federal financial participation required the state and local government to rent additional space to carry out a government mandate.

Q. **May the space costs that are reclassified to the other direct cost base be recovered through direct billings?**

A. No. These space costs are the financial responsibility of the organization.

Q. **When occupancy costs are part of the approved statewide costs, how are they treated for Restricted Rate purposes?**

A. They are disallowed, except where allowable under 34 CFR 76.568 (b). The disallowed amount is not placed in the base, because these costs are not incurred by the recipient.

## APPENDICES

**APPENDIX I**

**OMB CIRCULAR NO. A-87**  
**“Cost Principles for State, Local and**  
**Indian Tribal Governments”**

**Attachment B - Selected Items of Cost**

## **Appendix I**

### **OMB Circular No. A-87 Cost Principles for State, Local and Indian Tribal Governments**

#### **Attachment B - Selected Items of Cost**

On May 4, 1995, the Office of Management and Budget issued the final, revised Circular A-87 and was published in the Federal Register on May 19, 1995 (60 FR 26484-26507). This Circular establishes principles and standards for determining costs for federal awards carried out through grants, cost reimbursement contracts, and other agreements with state and local governments and federally-recognized Indian tribal governments. The revised cost principles shall be applied to indirect cost proposals submitted or prepared for a governmental unit's fiscal year that begins on or after September 1, 1995.

The most significant changes are found in Attachment B to OMB Circular A-87 where selected items of cost are addressed. For purposes of this Guide, a copy is included within this Appendix, and some of the significant changes are summarized below:

<b><u>No./Cost Item</u></b>	<b><u>Description of Change</u></b>
9. Budgeting.	The specific prohibition of "budgeting costs" attributable to routine costs of government has been deleted.
11. Compensation for Personnel Services	Significant changes are: (i) Criteria for determining what is reasonable compensation. (ii) An expanded fringe benefits discussion has been rolled into this section that explains, among other things, how costs are claimed when using accrual or cash basis of accounting. (iii) Considerable attention has been given to the accounting and claiming of pension costs. (iv) Detailed requirements have been added concerning salary support and time distribution systems. (v) A new subsection on "donated services" has been added which prohibits reimbursement of such services but nevertheless requires that they be included in the base for purposes of allocating indirect costs.

<u>No./Cost Item</u>	<u>Description of Change</u>
15. Depreciation and Use Allowance	This expanded section adds: (i) the Generally Accepted Accounting Principle requirement that the assets of enterprise funds be capitalized; (ii) that Governmental subdivisions may not be considered donors for purposes of establishing an asset's value at fair market value.; (iii) the acceptability of componentization of buildings; (iv) that classes of assets shall be the same basis as used in the financial statements, except for enterprise funds; and (v) when converting from use allowance to depreciation, the balance to be depreciated will be computed using a pro forma depreciation schedule starting with the date of acquisition.
19. Equipment and Other Capital Expenditures	This item of cost has been changed to: (i) define what is a capital expenditure; (ii) allow governments to establish a capitalization threshold at the lesser of \$5,000 or the threshold used in the preparation of the financial statements; (iii) clarifies that capital expenditures may only be allowed as a direct cost with prior approval; and (iv) provides guidance on how unamortized portions of assets are to be handled when a governmental unit changes its capitalization policy.
21. Fund Raising and Investment Management Costs (New Section)	Fund raising and general investment activities/costs are unallowable but must be allocated indirect costs. Investment activities related to pension funds, self-insurance funds, etc. are allowable.
22. Gains and Losses on Disposition of Depreciable Property and Other Capital Assets and Substantial Relocation of Federal Programs. (New Section)	While gains and losses must be accounted for in the current period, several methods are cited for handling the adjustment. Where federal programs are relocated from a facility in which there was federal participation in that facility, adjustments can be required by the cognizant agency.

No./Cost Item

Description of Change

26. Interest.

Interest is now allowable on equipment acquired before or after the effective date of the revised Circular. However, for existing debt, only interest expense incurred/paid in the government's fiscal year beginning on or after September 1, 1995 is allowable. Retroactive claims for interest paid in prior periods is unallowable. It also requires, for facilities, that earnings on construction borrowing be offset against income expense. Where depreciation and interest expense exceeds principal and interest payments (positive cash flow), the state is required to "negotiate" the amount of allowable interest with the cognizant agency. While no change was made concerning the allowability of interest for facilities, the section does clarify that interest is allowable for reconstruction or remodeling completed after October 1, 1980.

39. Taxes.

This item has been qualified to exclude as allowable those taxes that are self-imposed and otherwise disproportionately effect federal programs. This qualifier becomes effective on January 1, 1998.

# **Circular No. A-87**

## **Attachment B**

### **SELECTED ITEMS OF COST**

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Sections 1 through 42 provide principles to be applied in establishing the allowability or unallowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. A cost is allowable for Federal reimbursement only to the extent of benefits received by Federal awards and its conformance with the general policies and principles stated in Attachment A to this Circular. Failure to mention a particular item of cost in these sections is not intended to imply that it is either allowable or unallowable; rather, determination of allowability in each case should be based on the treatment or standards provided for similar or related items of cost.

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- 1. Accounting. The cost of establishing and maintaining accounting and other information systems is allowable.
- 2. Advertising and public relations costs.
  - a. The term "advertising costs" means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.
  - b. The term "public relations" includes community relations and means those activities dedicated to maintaining the image of the governmental unit or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.
  - c. Advertising costs are allowable only when incurred for the recruitment of personnel, the procurement of goods and services, the disposal of surplus materials, and any other specific

purposes necessary to meet the requirements of the Federal award. Advertising costs associated with the disposal of surplus materials are not allowable where all disposal costs are reimbursed based on a standard rate as specified in the grants management common rule.

d. Public relations costs are allowable when:

1. Specifically required by the Federal award and then only as a direct cost;
2. Incurred to communicate with the public and press pertaining to specific activities or accomplishments that result from performance of the Federal award and then only as a direct cost; or
3. Necessary to conduct general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary to keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, etc.

e. Unallowable advertising and public relations costs include the following:

1. All advertising and public relations costs other than as specified in subsections c. and d.;
2. Except as otherwise permitted by these cost principles, costs of conventions, meetings, or other events related to other activities of the governmental unit including:
  - (a) Costs of displays, demonstrations, and exhibits;
  - (b) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and
  - (c) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;
3. Costs of promotional items and memorabilia, including models, gifts, and souvenirs; and
4. Costs of advertising and public relations designed solely to promote the governmental unit.

3. Advisory councils. Costs incurred by advisory councils or committees are allowable as a direct cost where authorized by the Federal awarding agency or as an indirect cost where allocable to Federal awards.

4. Alcoholic beverages. Costs of alcoholic beverages are unallowable.
5. Audit services. The costs of audits are allowable provided that the audits were performed in accordance with the Single Audit Act, as implemented by Circular A-128, "Audits of State and Local Governments." Generally, the percentage of costs charged to Federal awards for a single audit shall not exceed the percentage derived by dividing Federal funds expended by total funds expended by the recipient or subrecipient (including program matching funds) during the fiscal year. The percentage may be exceeded only if appropriate documentation demonstrates higher actual costs.

Other audit costs are allowable if specifically approved by the awarding or cognizant agency as a direct cost to an award or included as an indirect cost in a cost allocation plan or rate.
6. Automatic electronic data processing. The cost of data processing services is allowable (but see section 19, Equipment and other capital expenditures).
7. Bad debts. Any losses arising from uncollectible accounts and other claims, and related costs, are unallowable unless provided for in Federal program award regulations.
8. Bonding costs. Costs of bonding employees and officials are allowable to the extent that such bonding is in accordance with sound business practice.
9. Budgeting. Costs incurred for the development, preparation, presentation, and execution of budgets are allowable.
10. Communications. Costs of telephone, mail, messenger, and similar communication services are allowable.
11. Compensation for personnel services.
  - a. General. Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under Federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular, and that the total compensation for individual employees:
    1. Is reasonable for the services rendered and conforms to the established policy of the governmental unit consistently applied to both Federal and non-Federal activities;
    2. Follows an appointment made in accordance with a governmental unit's laws and rules and meets merit system or other requirements required by Federal law, where applicable; and

3. Is determined and supported as provided in subsection h.
- b. Reasonableness. Compensation for employees engaged in work on Federal awards will be considered reasonable to the extent that it is consistent with that paid for similar work in other activities of the governmental unit. In cases where the kinds of employees required for Federal awards are not found in the other activities of the governmental unit, compensation will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor market in which the employing government competes for the kind of employees involved. Compensation surveys providing data representative of the labor market involved will be an acceptable basis for evaluating reasonableness.
- c. Unallowable costs. Costs which are unallowable under other sections of these principles shall not be allowable under this section solely on the basis that they constitute personnel compensation.
- d. Fringe benefits.
  1. Fringe benefits are allowances and services provided by employers to their employees as compensation in addition to regular salaries and wages. Fringe benefits include, but are not limited to, the costs of leave, employee insurance, pensions, and unemployment benefit plans. Except as provided elsewhere in these principles, the costs of fringe benefits are allowable to the extent that the benefits are reasonable and are required by law, governmental unit-employee agreement, or an established policy of the governmental unit.
  2. The cost of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, holidays, court leave, military leave, and other similar benefits, are allowable if:
    - (a) they are provided under established written leave policies;
    - (b) the costs are equitably allocated to all related activities, including Federal awards; and,
    - (c) the accounting basis (cash or accrual) selected for costing each type of leave is consistently followed by the governmental unit.
  3. When a governmental unit uses the cash basis of accounting, the cost of leave is recognized in the period that the leave is taken and paid for. Payments for unused leave when an employee retires or terminates employment are allowable in the year of payment provided they are allocated as a general administrative expense to all activities of the governmental unit or component.
  4. The accrual basis may be only used for those types of leave for which a liability as defined by Generally Accepted Accounting Principles (GAAP) exists when the leave is earned. When a governmental unit uses the accrual basis of accounting, in accordance with GAAP, allowable leave costs are the lesser of the amount accrued or funded.

5. The cost of fringe benefits in the form of employer contributions or expenses for social security; employee life, health, unemployment, and worker's compensation insurance (except as indicated in section 25, Insurance and indemnification); pension plan costs (see subsection e.); and other similar benefits are allowable, provided such benefits are granted under established written policies. Such benefits, whether treated as indirect costs or as direct costs, shall be allocated to Federal awards and all other activities in a manner consistent with the pattern of benefits attributable to the individuals or group(s) of employees whose salaries and wages are chargeable to such Federal awards and other activities.
- e. Pension plan costs. Pension plan costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.
  1. For pension plans financed on a pay-as-you-go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.
  2. Pension costs calculated using an actuarial cost-based method recognized by GAAP are allowable for a given fiscal year if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursement and the governmental unit's contribution to the pension fund. Adjustments may be made by cash refund or other equitable procedures to compensate the Federal Government for the time value of Federal reimbursements in excess of contributions to the pension fund.
  3. Amounts funded by the governmental unit in excess of the actuarially determined amount for a fiscal year may be used as the governmental unit's contribution in future periods.
  4. When a governmental unit converts to an acceptable actuarial cost method, as defined by GAAP, and funds pension costs in accordance with this method, the unfunded liability at the time of conversion shall be allowable if amortized over a period of years in accordance with GAAP.
  5. The Federal Government shall receive an equitable share of any previously allowed pension costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.
- f. Post-retirement health benefits. Post-retirement health benefits (PRHB) refers to costs of health insurance or health services not included in a pension plan covered by subsection e. for

retirees and their spouses, dependents, and survivors. PRHB costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written polices of the governmental unit.

1. For PRHB financed on a pay as-you-go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.
2. PRHB costs calculated using an actuarial cost method recognized by GAAP are allowable if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursements and the governmental unit's contributions to the PRHB fund. Adjustments may be made by cash refund, reduction in current year's PRHB costs, or other equitable procedures to compensate the Federal Government for the time value of Federal reimbursements in excess of contributions to the PRHB fund.
3. Amounts funded in excess of the actuarially determined amount for a fiscal year may be used as the government's contribution in a future period.
4. When a governmental unit converts to an acceptable actuarial cost method and funds PRHB costs in accordance with this method, the initial unfunded liability attributable to prior years shall be allowable if amortized over a period of years in accordance with GAAP, or, if no such GAAP period exists, over a period negotiated with the cognizant agency.
5. To be allowable in the current year, the PRHB costs must be paid either to:
  - (a) An insurer or other benefit provider as current year costs or premiums, or
  - (b) An insurer or trustee to maintain a trust fund or reserve for the sole purpose of providing post-retirement benefits to retirees and other beneficiaries.
6. The Federal Government shall receive an equitable share of any amounts of previously allowed post-retirement benefit costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.

g. Severance pay.

1. Payments in addition to regular salaries and wages made to workers whose employment is being terminated are allowable to the extent that, in each case, they are required by (a) law, (b) employer-employee agreement, or (c) established written

policy.

2. Severance payments (but not accruals) associated with normal turnover are allowable. Such payments shall be allocated to all activities of the governmental unit as an indirect cost.
3. Abnormal or mass severance pay will be considered on a case-by-case basis and is allowable only if approved by the cognizant Federal agency.

h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.

1. Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.
2. No further documentation is required for the salaries and wages of employees who work in a single indirect cost activity.
3. Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.
4. Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation which meets the standards in subsection (5) unless a statistical sampling system (see subsection (6)) or other substitute system has been approved by the cognizant Federal agency. Such documentary support will be required where employees work on:
  - (a) More than one Federal award,
  - (b) A Federal award and a non-Federal award,
  - (c) An indirect cost activity and a direct cost activity,
  - (d) Two or more indirect activities which are allocated using different allocation bases, or

(e) An unallowable activity and a direct or indirect cost activity.

5. Personnel activity reports or equivalent documentation must meet the following standards:

(a) They must reflect an after-the-fact distribution of the actual activity of each employee,

(b) They must account for the total activity for which each employee is compensated,

(c) They must be prepared at least monthly and must coincide with one or more pay periods, and

(d) They must be signed by the employee.

(e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards but may be used for interim accounting purposes, provided that:

(i) The governmental unit's system for establishing the estimates produces reasonable approximations of the activity actually performed;

(ii) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made. Costs charged to Federal awards to reflect adjustments made as a result of the activity actually performed may be recorded annually if the quarterly comparisons show the differences between budgeted and actual costs are less than ten percent; and

(iii) The budget estimates or other distribution percentages are revised at least quarterly, if necessary, to reflect changed circumstances.

6. Substitute systems for allocating salaries and wages to Federal awards may be used in place of activity reports. These systems are subject to approval if required by the cognizant agency. Such systems may include, but are not limited to, random moment sampling, case counts, or other quantifiable measures of employee effort.

(a) Substitute systems which use sampling methods (primarily for Aid to Families with Dependent Children (AFDC), Medicaid, and other public assistance programs) must meet acceptable statistical sampling standards including:

(i) The sampling universe must include all of the employees whose salaries

and wages are to be allocated based on sample results except as provided in subsection (c);

(ii) The entire time period involved must be covered by the sample; and

(iii) The results must be statistically valid and applied to the period being sampled.

(b) Allocating charges for the sampled employees' supervisors, clerical and support staffs, based on the results of the sampled employees, will be acceptable.

(c) Less than full compliance with the statistical sampling standards noted in subsection (a) may be accepted by the cognizant agency if it concludes that the amounts to be allocated to Federal awards will be minimal, or if it concludes that the system proposed by the governmental unit will result in lower costs to Federal awards than a system which complies with the standards.

7. Salaries and wages of employees used in meeting cost sharing or matching requirements of Federal awards must be supported in the same manner as those claimed as allowable costs under Federal awards.

#### I. Donated services.

1. Donated or volunteer services may be furnished to a governmental unit by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the provisions of the Common Rule.

2. The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the governmental unit's indirect costs or rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs.

3. To the extent feasible, donated services will be supported by the same methods used by the governmental unit to support the allocability of regular personnel services.

12. Contingencies. Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, or intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see subsection 25.c.), pension plan reserves (see subsection 11.e.), and

post-retirement health and other benefit reserves (see subsection 11.f.) computed using acceptable actuarial cost methods.

13. Contributions and donations. Contributions and donations, including cash, property, and services, by governmental units to others, regardless of the recipient, are unallowable.

14. Defense and prosecution of criminal and civil proceedings, and claims.

a. The following costs are unallowable for contracts covered by 10 U.S.C. 2324(k), "Allowable costs under defense contracts."

1. Costs incurred in defense of any civil or criminal fraud proceeding or similar proceeding (including filing of false certification brought by the United States where the contractor is found liable or has pleaded nolo contendere to a charge of fraud or similar proceeding (including filing of a false certification)).

2. Costs incurred by a contractor in connection with any criminal, civil or administrative proceedings commenced by the United States or a State to the extent provided in 10 U.S.C. 2324(k).

b. Legal expenses required in the administration of Federal programs are allowable. Legal expenses for prosecution of claims against the Federal Government are unallowable.

15. Depreciation and use allowances.

a. Depreciation and use allowances are means of allocating the cost of fixed assets to periods benefitting from asset use. Compensation for the use of fixed assets on hand may be made through depreciation or use allowances. A combination of the two methods may not be used in connection with a single class of fixed assets (e.g., buildings, office equipment, computer equipment, etc.) except as provided in subsection g. Except for enterprise funds and internal service funds that are included as part of a State/local cost allocation plan, classes of assets shall be determined on the same basis used for the government-wide financial statements.

b. The computation of depreciation or use allowances shall be based on the acquisition cost of the assets involved. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used. The value of an asset donated to the governmental unit by an unrelated third party shall be its fair market value at the time of donation. Governmental or quasi-governmental organizations located within the same State shall not be considered unrelated third parties for this purpose.

c. The computation of depreciation or use allowances will exclude:

1. The cost of land;

1. The cost of land;
2. Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides; and
3. Any portion of the cost of buildings and equipment contributed by or for the governmental unit, or a related donor organization, in satisfaction of a matching requirement.

d. Where the use allowance method is followed, the use allowance for buildings and improvements (including land improvements, such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition costs. The use allowance for equipment will be computed at an annual rate not exceeding 6 2/3 percent of acquisition cost. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components (e.g., plumbing system, heating and air condition, etc.) cannot be segregated from the building's shell. The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, modular furniture, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the destruction of, or need for costly or extensive alterations or repairs, to the building or the equipment. Equipment that meets these criteria will be subject to the 6 2/3 percent equipment use allowance limitation.

e. Where the depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, historical usage patterns, technological developments, and the renewal and replacement policies of the governmental unit followed for the individual items or classes of assets involved. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions than in the later portions of its useful life, the straight line method of depreciation shall be used. Depreciation methods once used shall not be changed unless approved by the Federal cognizant or awarding agency. When the depreciation method is introduced for application to an asset previously subject to a use allowance, the annual depreciation charge thereon may not exceed the amount that would have resulted had the depreciation method been in effect from the date of acquisition of the asset. The combination of use allowances and depreciation applicable to the asset shall not exceed the total acquisition cost of the asset or fair market value at time of donation.

f. When the depreciation method is used for buildings, a building's shell may be segregated from the major component of the building (e.g., plumbing system, heating, and air conditioning

depreciated over a single useful life.

g. A reasonable use allowance may be negotiated for any assets that are considered to be fully depreciated, after taking into consideration the amount of depreciation previously charged to the government, the estimated useful life remaining at the time of negotiation, the effect of any increased maintenance charges, decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

h. Charges for use allowances or depreciation must be supported by adequate property records. Physical inventories must be taken at least once every two years (a statistical sampling approach is acceptable) to ensure that assets exist, and are in use. Governmental units will manage equipment in accordance with State laws and procedures. When the depreciation method is followed, depreciation records indicating the amount of depreciation taken each period must also be maintained.

16. Disbursing service. The cost of disbursing funds by the Treasurer or other designated officer is allowable.

17. Employee morale, health, and welfare costs. The costs of health or first-aid clinics and/or infirmaries, recreational facilities, employee counseling services, employee information publications, and any related expenses incurred in accordance with a governmental unit's policy are allowable. Income generated from any of these activities will be offset against expenses.

18. Entertainment. Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

19. Equipment and other capital expenditures.

a. As used in this section the following terms have the meanings as set forth below:

1. "Capital expenditure" means the cost of the asset including the cost to put it in place. Capital expenditure for equipment means the net invoice price of the equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in transit insurance, freight, and installation may be included in, or excluded from, capital expenditure cost in accordance with the governmental unit's regular accounting practices.

2. "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals the lesser of (a) the capitalization level established by the governmental unit for financial statement

purposes, or (b) \$5000.

3. "Other capital assets" mean buildings, land, and improvements to buildings or land that materially increase their value or useful life.
  - b. Capital expenditures which are not charged directly to a Federal award may be recovered through use allowances or depreciation on buildings, capital improvements, and equipment (see section 15). See also section 38 for allowability of rental costs for buildings and equipment.
  - c. Capital expenditures for equipment, including replacement equipment, other capital assets, and improvements which materially increase the value or useful life of equipment or other capital assets are allowable as a direct cost when approved by the awarding agency. Federal awarding agencies are authorized at their option to waive or delegate this approval requirement.
  - d. Items of equipment with an acquisition cost of less than \$5000 are considered to be supplies and are allowable as direct costs of Federal awards without specific awarding agency approval.
  - e. The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by (1) continuing to claim the otherwise allowable use allowances or depreciation charges on the equipment or by (2) amortizing the amount to be written off over a period of years negotiated with the cognizant agency.
  - f. When replacing equipment purchased in whole or in part with Federal funds, the governmental unit may use the equipment to be replaced as a trade-in or sell the property and use the proceeds to offset the cost of the replacement property.
20. Fines and penalties. Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, Federal, State, local, or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the Federal award or written instructions by the awarding agency authorizing in advance such payments.
21. Fund raising and investment management costs.
  - a. Costs of organized fund raising, including financial campaigns, solicitation of gifts and bequests, and similar expenses incurred to raise capital or obtain contributions are unallowable, regardless of the purpose for which the funds will be used.
  - b. Costs of investment counsel and staff and similar expenses incurred to enhance income

from investments are unallowable. However, such costs associated with investments covering pension, self-insurance, or other funds which include Federal participation allowed by this Circular are allowable.

c. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in subsection C.3.b. of Attachment A.

22. Gains and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs.

a. 1. Gains and losses on the sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to the asset cost grouping(s) in which the property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate asset cost grouping(s) shall be the difference between the amount realized on the property and the undepreciated basis of the property.

2. Gains and losses on the disposition of depreciable property shall not be recognized as a separate credit or charge under the following conditions:

(a) The gain or loss is processed through a depreciation account and is reflected in the depreciation allowable under sections 15 and 19.

(b) The property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into account in determining the depreciation cost basis of the new item.

(c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in subsection 25.d.

(d) Compensation for the use of the property was provided through use allowances in lieu of depreciation.

b. Substantial relocation of Federal awards from a facility where the Federal Government participated in the financing to another facility prior to the expiration of the useful life of the financed facility requires Federal agency approval. The extent of the relocation, the amount of the Federal participation in the financing, and the depreciation charged to date may require negotiation of space charges for Federal awards.

c. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in subsection a., e.g., land or included in the fair market value used in any adjustment resulting from a relocation of Federal awards covered in subsection b. shall be excluded in computing Federal award costs.

**23. General government expenses.**

a. The general costs of government are unallowable (except as provided in section 41). These include:

1. Salaries and expenses of the Office of the Governor of a State or the chief executive of a political subdivision or the chief executives of federally-recognized Indian tribal governments;
2. Salaries and other expenses of State legislatures, tribal councils, or similar local governmental bodies, such as county supervisors, city councils, school boards, etc., whether incurred for purposes of legislation or executive direction;
3. Cost of the judiciary branch of a government;
4. Cost of prosecutorial activities unless treated as a direct cost to a specific program when authorized by program regulations (however, this does not preclude the allowability of other legal activities of the Attorney General); and
5. Other general types of government services normally provided to the general public, such as fire and police, unless provided for as a direct cost in program regulations.

b. For federally-recognized Indian tribal governments and Councils Of Governments (COGs), the portion of salaries and expenses directly attributable to managing and operating Federal programs by the chief executive and his staff is allowable.

**24. Idle facilities and idle capacity.**

a. As used in this section the following terms have the meanings set forth below:

1. "Facilities" means land and buildings or any portion thereof, equipment individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the governmental unit.
2. "Idle facilities" means completely unused facilities that are excess to the governmental unit's current needs.
3. "Idle capacity" means the unused capacity of partially used facilities. It is the difference between (a) that which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays and (b) the extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis should be used if it can be shown that this amount of usage would normally be expected for the

type of facility involved.

4. "Cost of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs, e.g., insurance, interest, and depreciation or use allowances.
- b. The costs of idle facilities are unallowable except to the extent that:
  1. They are necessary to meet fluctuations in workload; or
  2. Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subsection, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending on the initiative taken to use, lease, or dispose of such facilities.
  - c. The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided that the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by use on other Federal awards, subletting, renting, or sale, in accordance with sound business, economic, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be considered idle facilities.
25. Insurance and indemnification.
  - a. Costs of insurance required or approved and maintained, pursuant to the Federal award, are allowable.
  - b. Costs of other insurance in connection with the general conduct of activities are allowable subject to the following limitations:
    1. Types and extent and cost of coverage are in accordance with the governmental unit's policy and sound business practice.
    2. Costs of insurance or of contributions to any reserve covering the risk of loss of, or damage to, Federal Government property are unallowable except to the extent that the awarding agency has specifically required or approved such costs.
    - c. Actual losses which could have been covered by permissible insurance (through a self-insurance program or otherwise) are unallowable, unless expressly provided for in the

Federal award or as described below. However, the Federal Government will participate in actual losses of a self insurance fund that are in excess of reserves. Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice, and minor losses not covered by insurance, such as spoilage, breakage, and disappearance of small hand tools, which occur in the ordinary course of operations, are allowable.

d. Contributions to a reserve for certain self-insurance programs including workers compensation, unemployment compensation, and severance pay are allowable subject to the following provisions:

1. The type of coverage and the extent of coverage and the rates and premiums would have been allowed had insurance (including reinsurance) been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made, shall not exceed the discounted present value of the liability. The rate used for discounting the liability must be determined by giving consideration to such factors as the governmental unit's settlement rate for those liabilities and its investment rate of return.
2. Earnings or investment income on reserves must be credited to those reserves.
3. Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and updated at least biennially for each major risk being insured and take into account any reinsurance, coinsurance, etc. Reserve levels related to employee-related coverages will normally be limited to the value of claims (a) submitted and adjudicated but not paid, (b) submitted but not adjudicated, and (c) incurred but not submitted. Reserve levels in excess of the amounts based on the above must be identified and justified in the cost allocation plan or indirect cost rate proposal.
4. Accounting records, actuarial studies, and cost allocations (or billings) must recognize any significant differences due to types of insured risk and losses generated by the various insured activities or agencies of the governmental unit. If individual departments or agencies of the governmental unit experience significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations or other techniques resulting in an equitable allocation.
5. Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund), refunds shall be made to the Federal Government for its share of funds transferred, including earned or imputed interest from the date of transfer.

e. Actual claims paid to or on behalf of employees or former employees for workers' compensation, unemployment compensation, severance pay, and similar employee benefits

(e.g., subsection 11.f. for post retirement health benefits), are allowable in the year of payment provided (1) the governmental unit follows a consistent costing policy and (2) they are allocated as a general administrative expense to all activities of the governmental unit.

- f. Insurance refunds shall be credited against insurance costs in the year the refund is received.
- g. Indemnification includes securing the governmental unit against liabilities to third persons and other losses not compensated by insurance or otherwise. The Federal Government is obligated to indemnify the governmental unit only to the extent expressly provided for in the Federal award, except as provided in subsection d.
- h. Costs of commercial insurance that protects against the costs of the contractor for correction of the contractor's own defects in materials or workmanship are unallowable.

26. Interest.

- a. Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in subsection b. or authorized by Federal legislation.
- b. Financing costs (including interest) paid or incurred on or after the effective date of this Circular associated with the otherwise allowable costs of building acquisition, construction, or fabrication, reconstruction or remodeling completed on or after October 1, 1980 is allowable, subject to the conditions in (1)-(4). Financing costs (including interest) paid or incurred on or after the effective date of this Circular associated with otherwise allowable costs of equipment is allowable, subject to the conditions in (1)-(4).
  1. The financing is provided (from other than tax or user fee sources) by a bona fide third party external to the governmental unit;
  2. The assets are used in support of Federal awards;
  3. Earnings on debt service reserve funds or interest earned on borrowed funds pending payment of the construction or acquisition costs are used to offset the current period's cost or the capitalized interest, as appropriate. Earnings subject to being reported to the Federal Internal Revenue Service under arbitrage requirements are excludable.
  4. Governmental units will negotiate the amount of allowable interest whenever cash payments (interest, depreciation, use allowances, and contributions) exceed the governmental unit's cash payments and other contributions attributable to that portion of real property used for Federal awards.

27. Lobbying. The cost of certain influencing activities associated with obtaining grants,

contracts, cooperative agreements, or loans is an unallowable cost. Lobbying with respect to certain grants, contracts, cooperative agreements, and loans shall be governed by the common rule, "New Restrictions on Lobbying" published at 55 FR 6736 (February 26, 1990), including definitions, and the Office of Management and Budget "Government-wide Guidance for New Restrictions on Lobbying" and notices published at 54 FR 52306 (December 20, 1989), 55 FR 24540 (June 15, 1990), and 57 FR 1772 (January 15, 1992), respectively.

28. Maintenance, operations, and repairs. Unless prohibited by law, the cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, necessary maintenance, normal repairs and alterations, and the like are allowable to the extent that they: (1) keep property (including Federal property, unless otherwise provided for) in an efficient operating condition, (2) do not add to the permanent value of property or appreciably prolong its intended life, and (3) are not otherwise included in rental or other charges for space. Costs which add to the permanent value of property or appreciably prolong its intended life shall be treated as capital expenditures (see sections 15 and 19).

29. Materials and supplies. The cost of materials and supplies is allowable. Purchases should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing, consistently applied. Incoming transportation charges are a proper part of materials and supply costs.

30. Memberships, subscriptions, and professional activities.

- a. Costs of the governmental unit's memberships in business, technical, and professional organizations are allowable.
- b. Costs of the governmental unit's subscriptions to business, professional, and technical periodicals are allowable.
- c. Costs of meetings and conferences where the primary purpose is the dissemination of technical information, including meals, transportation, rental of meeting facilities, and other incidental costs are allowable.
- d. Costs of membership in civic and community, social organizations are allowable as a direct cost with the approval of the Federal awarding agency.
- e. Costs of membership in organizations substantially engaged in lobbying are unallowable.

31. Motor pools. The costs of a service organization which provides automobiles to user governmental units at a mileage or fixed rate and/or provides vehicle maintenance, inspection, and repair services are allowable.

32. Pre-award costs. Pre-award costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

33. Professional service costs.

a. Cost of professional and consultant services rendered by persons or organizations that are members of a particular profession or possess a special skill, whether or not officers or employees of the governmental unit, are allowable, subject to section 14 when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government.

b. Retainer fees supported by evidence of bona fide services available or rendered are allowable.

34. Proposal costs. Costs of preparing proposals for potential Federal awards are allowable. Proposal costs should normally be treated as indirect costs and should be allocated to all activities of the governmental unit utilizing the cost allocation plan and indirect cost rate proposal. However, proposal costs may be charged directly to Federal awards with the prior approval of the Federal awarding agency.

35. Publication and printing costs. Publication costs, including the costs of printing (including the processes of composition, plate-making, press work, and binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling are allowable.

36. Rearrangements and alterations. Costs incurred for ordinary and normal rearrangement and alteration of facilities are allowable. Special arrangements and alterations costs incurred specifically for a Federal award are allowable with the prior approval of the Federal awarding agency.

37. Reconversion costs. Costs incurred in the restoration or rehabilitation of the governmental unit's facilities to approximately the same condition existing immediately prior to commencement of Federal awards, less costs related to normal wear and tear, are allowable.

38. Rental costs.

a. Subject to the limitations described in subsections b. through d. of this section, rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and, the type, life expectancy, condition, and value of the property leased.

- b. Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the governmental unit continued to own the property.
- c. Rental costs under less-than-arms-length leases are allowable only up to the amount that would be allowed had title to the property vested in the governmental unit. For this purpose, less-than-arms-length leases include, but are not limited to, those where:
  - 1. One party to the lease is able to control or substantially influence the actions of the other;
  - 2. Both parties are parts of the same governmental unit; or
  - 3. The governmental unit creates an authority or similar entity to acquire and lease the facilities to the governmental unit and other parties.
- d. Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount that would be allowed had the governmental unit purchased the property on the date the lease agreement was executed. This amount would include expenses such as depreciation or use allowance, maintenance, and insurance. The provisions of Financial Accounting Standards Board Statement 13 shall be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in section 26.

39. Taxes.

- a. Taxes that a governmental unit is legally required to pay are allowable, except for self-assessed taxes that disproportionately affect Federal programs or changes in tax policies that disproportionately affect Federal programs. This provision becomes effective for taxes paid during the governmental unit's first fiscal year that begins on or after January 1, 1998, and applies thereafter.
- b. Gasoline taxes, motor vehicle fees, and other taxes that are in effect user fees for benefits provided to the Federal Government are allowable.
- c. This provision does not restrict the authority of Federal agencies to identify taxes where Federal participation is inappropriate. Where the identification of the amount of unallowable taxes would require an inordinate amount of effort, the cognizant agency may accept a reasonable approximation thereof.

40. Training. The cost of training provided for employee development is allowable.

41. Travel costs.

- a. General. Travel costs are allowable for expenses for transportation, lodging, subsistence, and related items incurred by employees traveling on official business. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip, and results in charges consistent with those normally allowed in like circumstances in non-federally-sponsored activities. Notwithstanding the provisions of section 23, travel costs of officials covered by that section, when specifically related to Federal awards, are allowable with the prior approval of a grantor agency.
- b. Lodging and subsistence. Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, shall be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the governmental unit in its regular operations as a result of the governmental unit's policy. In the absence of a written governmental unit policy regarding travel costs, the rates and amounts established under subchapter I of Chapter 57 of Title 5, United States Code "Travel and Subsistence Expenses; Mileage Allowances," or by the Administrator of General Services, or the President (or his designee) pursuant to any provisions of such subchapter shall be used as guidance for travel under Federal awards (41 U.S.C. 420, "Travel Expenses of Government Contractors").
- c. Commercial air travel. Airfare costs in excess of the customary standard (coach or equivalent) airfare, are unallowable except when such accommodations would: require circuitous routing, require travel during unreasonable hours, excessively prolong travel, greatly increase the duration of the flight, result in increased cost that would offset transportation savings, or offer accommodations not reasonably adequate for the medical needs of the traveler. Where a governmental unit can reasonably demonstrate to the awarding agency either the nonavailability of customary standard airfare or Federal Government contract airfare for individual trips or, on an overall basis, that it is the governmental unit's practice to make routine use of such airfare, specific determinations of nonavailability will generally not be questioned by the Federal Government, unless a pattern of avoidance is detected. However, in order for airfare costs in excess of the customary standard commercial airfare to be allowable, e.g., use of first-class airfare, the governmental unit must justify and document on a case-by-case basis the applicable condition(s) set forth above.
- d. Air travel by other than commercial carrier. Cost of travel by governmental unit-owned, -leased, or -chartered aircraft, as used in this section, includes the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, interest, insurance, and other related costs. Costs of travel via governmental unit-owned, -leased, or -chartered aircraft are unallowable to the extent they exceed the cost of allowable commercial air travel, as provided for in subsection c.

42. Underrecovery of costs under Federal agreements. Any excess costs over the Federal contribution under one award agreement are unallowable under other award agreements.

## **APPENDIX II**

### **U.S. Department of Education Cognizant Agency Assignments under OMB Circular A-87**

## **APPENDIX II**

### **U.S. DEPARTMENT OF EDUCATION COGNIZANT AGENCY ASSIGNMENTS UNDER OMB CIRCULAR NO. A-87**

<b><u>STATES</u></b>	<b><u>AGENCY</u></b>
Alabama	Education
Alaska	Education - Vocational Rehabilitation
Arizona	Education
Arkansas	Education
California	Rehabilitation Services
Colorado	Education
Connecticut	Education
Delaware	Post-Secondary Education Commission
District of Columbia	Rehabilitation
Florida	Santa Clara
Georgia	State Library
Hawaii	Education
Idaho	Education
Illinois	Public Instruction
Indiana	State
Iowa	Public Schools
Kansas	Education
Kentucky	Governor's Office
	State
	Education
	Technical Adult Education
	Education
	Education
	Board of Education
	Rehabilitation Services
	Education
	Blind
	Public Instruction
	Vocational Rehabilitation
	Education
	Education
	Workforce Development Cabinet

**STATES**

Louisiana  
Maine  
Maryland  
Massachusetts

Michigan

Minnesota  
Mississippi

Missouri  
Montana

Nebraska  
Nevada  
New Hampshire

New Jersey

New Mexico

New York  
North Carolina

North Dakota  
Ohio

**AGENCY**

Education  
Higher Education  
Educational & Cultural Service  
Education  
Blind  
Corrections  
Disability  
Education  
Educational Telecommunications  
Library  
Corrections  
Education  
Education  
Bd. for Community & Junior Colleges  
Education  
Youth Services  
Elementary & Secondary Education  
Education  
Library  
Education  
Education  
Comm. on Disabilities  
Education  
Governor's Office  
State Library  
Vocational Technical Education  
Education  
Higher Education  
Student Assistance  
Blind  
Education  
Youth Division  
Education  
Community Colleges  
Cultural Resources  
Public Education  
Public Instruction  
Education  
Rehabilitation Services Commission

<u>STATES</u>	<u>AGENCY</u>
Oklahoma	Education Handicapped Vocational & Technical Education
Oregon	Education
Pennsylvania	Education
Puerto Rico	Education
Rhode Island	Education
South Carolina	Vocational Rehabilitation
South Dakota	Education & Cultural Affairs
Tennessee	Education
Texas	Education Agency Rehabilitation Commission
Utah	Education Office
Vermont	Education
Virginia	Education
Washington	Public Instruction
West Virginia	Education Vocational Educational Board
Wisconsin	Public Instruction Technical College System Board
Wyoming	Education

COUNTIESAGENCY

Nashville - Davidson, Tenn.  
Montgomery, Va.

Education  
Education

CITIESAGENCY

Hartford, Conn.  
New Haven, Conn.  
Baltimore, Md.  
Boston, Mass.  
Brockton, Mass.  
Lawrence, Mass.  
Buffalo, NY  
  
New York, NY  
Philadelphia, Penn.  
Providence, RI  
Houston, Tx.  
Chesapeake, Va.  
Newport News, Va.  
Norfolk, Va.  
Virginia Beach, Va.

Education  
Education  
Education  
Education  
Education  
Education  
Education  
Transportation  
Board of Education  
Schools  
Federal Programs  
Library  
All  
All  
Education  
All

## **APPENDIX III**

### **Education Department General Administrative Regulations, 34 CFR Parts 75 and 76**

# **Federal Register**

**November 17, 1994**

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## **Part III**

### **Department of Education**

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**34 CFR Parts 75 and 76  
Direct Grant Programs and State-  
Administered Programs; Final Rule**

DEPARTMENT OF EDUCATION  
34 CFR Parts 75 and 76  
RIN 1880-AA50  
Direct Grant Programs and State-Administered Programs  
AGENCY: Department of Education.  
ACTION: Final regulations.

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SUMMARY: The Secretary amends the Department's regulations on direct grant programs and State-administered programs to clarify the requirements and procedures for establishing and applying indirect cost rates under programs administered by the Department.

EFFECTIVE DATE: These regulations take effect on December 19, 1994.

FOR FURTHER INFORMATION CONTACT: Glenn Riley, U.S. Department of Education, 400 Maryland Avenue, S.W., Room 3636, ROB-3, Washington, D.C. 20202-4700. Telephone: (202) 708-7640. Individuals who use a telecommunications device for the deaf (TDD) may call the Federal Information Relay Service (FIRS) at 1-800-877-8339 between 8 a.m. and 8 p.m., Eastern time, Monday through Friday.

SUPPLEMENTARY INFORMATION: On January 14, 1994, the Secretary published in the Federal Register (59 FR 2480) a notice of proposed rulemaking (NPRM) proposing to revise certain sections in the Education Department General Administrative Regulations (EDGAR) on indirect cost rates. These proposed revisions were intended to improve the administration of discretionary grants and to clarify for grantees the procedures and requirements of the Department.

The proposed regulations addressed a number of problems in this area of grants administration, including the computation and use of restricted indirect cost rates in programs with a statutory supplement-not-supplant requirement, the definition of a training grant, and the use of indirect costs as matching or cost-sharing.

Significant differences between the NPRM and this final regulation include changes to Secs. 75.561 and 76.561 to allow State educational agencies to approve multi-year indirect cost rates for local educational agencies, the deletion of research training programs from the definition of a training grant in Sec. 75.562, and the inclusion of a definition of "modified total direct cost base," also in Sec. 75.562.

## **Analysis of Comments and Changes**

In response to the Secretary's invitation in the NPRM, 21 parties submitted comments on the proposed regulations. An analysis of the comments and of the resulting changes in the regulations follows.

Substantive issues are discussed under the section of the regulations to which they pertain. Technical and other minor changes--and suggested changes the Secretary is not legally authorized to make under the applicable statutory authority--are not addressed.

### **Section 75.560 General Indirect Cost Rates; Exceptions**

Since the Department recently adopted the revised OMB Circular A-110 as 34 CFR Part 74, references in this section have been revised to be consistent with the new Part 74.

**Comments:** Several parties commented on the requirement that a recipient have a current indirect cost rate agreement to charge indirect costs to a grant, asking what should happen if a recipient has submitted an indirect cost proposal but has not received approval from the Department. One suggested that the Department should assign an indirect cost rate based on the applicant's last approved rate and another thought the applicant should be allowed to use its proposed rate.

**Discussion:** The Department now allows six months to review a rate proposal and negotiate a new rate, which is generally adequate time to complete the process. If for some reason a rate has not been approved on time, the use of a temporary rate would be considered by the Department. Since other changes to these regulations give the Department authority to establish temporary rates, no additional changes concerning temporary rates are necessary.

**Changes:** None.

**Comments:** Another commenter asked about the effect of the proposed regulations on contractors under a grant and whether this section requires contractors to obtain a rate, including a temporary rate if necessary, from the Department.

**Discussion:** Many contractors already have a negotiated indirect cost rate because they are direct recipients of Federal funds. Under current procedures State and local governments are expected to assign an indirect cost rate to a contractor or other lower tier organization

that does not already have one. Thus State educational agencies assign rates to their local educational agencies (see Sec. 75.561). These regulations do nothing to change these practices and contractors or other lower tier organizations are not expected to negotiate a rate with the Department.

Changes: None.

#### **Section 75.561 Approval of indirect cost rates.**

Comments: Several commenters were confused by the statement in Sec. 75.561(c) that the Secretary approves indirect cost rate agreements, an apparent conflict with the practice of the cognizant agency negotiating a rate with an applicant.

Discussion: The Secretary does negotiate indirect cost rates with applicants, but only when the Department is the cognizant agency. A change has been made to clarify this paragraph.

Changes: Section 75.561(a) has been revised to make it clear that the Secretary approves indirect cost rates for applicants when the Department is the cognizant agency.

Comments: One commenter suggested that State educational agencies have the same flexibility to approve multi-year indirect cost rates as the proposed revision to Sec. 75.561 would give the Secretary. The commenter observed that it would be more cost-effective, particularly for small local educational agencies, to have rates in effect for more than one year.

Discussion: The Secretary agrees with this comment and has made a change.

Changes: Section 75.561(b) has been revised to allow State educational agencies to approve indirect cost rates--for local educational agencies--that are in effect for more than one year.

#### **Section 75.562 Indirect cost rates for educational training projects.**

Comments: A commenter objected to the inclusion of research training programs in the proposed definition of an educational training grant, observing that OMB Circular A-21 specifies that research training is part of an institution's sponsored research activities.

Discussion: OMB Circular A-21, in Section B, Definition of Terms, states that the term "sponsored research" includes "activities

involving the training of individuals in research techniques (commonly called research training) \* \* \*." In order to be consistent with this circular, the Secretary has made a change in the definition of an educational training grant.

**Changes:** The phrase "including special research training programs" has been deleted from the definition of an educational training grant in Sec. 75.562(a).

**Comments:** A few commenters thought that the definition of a training grant was ambiguous and too broad. One suggested that it be limited to grants that were designated as training grants by statute or where the grant includes such costs as tuition and fees (so-called "flow-through" funds) that are used by the recipient to cover a portion of its indirect costs. Another asked if the Secretary would be using this definition in determining which grants are training grants, as stated in Sec. 75.562(b).

**Discussion:** The fact that the proposed definition of a training grant is broad and comprehensive is a reflection of the great variety of grants administered by the Department that are training grants. The definition suggested by the commenter would overly limit the designation of training grants and exclude certain programs that clearly are primarily for the provision of training. The intent of the definition is to provide the public with the criteria used by the Secretary in determining what is a training grant and a change has been made to make this clear.

**Changes:** Section 75.562(b) has been revised to indicate that the Secretary does use the definition of a training grant in paragraph (a) in determining which grants are educational training grants.

**Comments:** Several commenters objected to the Department's use of the eight percent limit on training grants and thought the rate negotiated by the recipient with its cognizant agency should be employed instead.

**Discussion:** Since its inception, the Department has consistently maintained the necessity of limiting the indirect cost rate on training grants. This policy was originally established when the Department was a component of the Department of Health, Education, and Welfare, now the Department of Health and Human Services (HHS). This policy is still in effect at HHS and is intended in part to maximize the number of projects funded under these programs. In addition, a number of training projects contain significant amounts of flow-through funds and therefore do not carry the same burden of overhead or administrative

costs as do other projects. The Secretary does not agree that the recipients of training grants should be reimbursed at their full negotiated rates and no change in this section has been made.

Changes: None.

Comments: Nine comments were received on the proposed revision to Sec. 75.562(c) that would require the training rate of eight percent to be applied to a modified total direct cost base, instead of using a base of total direct costs as in the current regulation. Commenters opposed this change on grounds that it would further reduce a grantee's ability to recover legitimate indirect costs under training grants and reduce the number of organizations that could afford to apply for those grants. Several commenters also asked for a definition of "modified total direct cost base."

Discussion: There is general agreement in the grants community that indirect costs should not be charged to activities that do not have significant administrative costs associated with them, such as "flow-through funds" (e.g., tuition, fees, and stipends). The Secretary proposed to revise these regulations to be consistent with this principle and to clarify for all interested parties what base should be used in computing indirect costs under a training grant. Though this change will reduce the indirect costs charged to the Department's grants for some recipients, the Secretary does not agree that the indirect cost base for training grants should include activities or costs that do not generate significant administrative expenses. However, the Secretary has made a change to clarify the term "modified total direct cost base."

Changes: Section 75.562(c) has been revised to include a definition of "modified total direct cost base." It has also been reworded to make it clearer that the paragraph is referring to the lesser amount of funds, not the lesser rate.

Comments: One commenter stated that the eight percent limitation should not apply to contractors under training grants, as required by Sec. 75.562(c)(1), since not all contractors are in a position to absorb the costs not covered by the limited rate.

Discussion: If the contractor is not conducting training activities, the eight percent limitation would not apply and the contractor could use its negotiated rate. However, a contractor that is conducting training under a training grant would still be subject to the limitation of eight percent. No change has been made in this paragraph.

Changes: None.

Comments: Thirteen commenters objected to the requirement in

Sec. 75.562(c)(3) that indirect costs in excess of the eight percent limitation may not be used to satisfy cost-sharing or matching requirements. Many cited the new provision in OMB Circular A-110 that allows the use of unrecovered indirect costs for this purpose, with the approval of the granting agency. Commenters were concerned that this limitation would make it difficult for many competent applicants to qualify for grants that require cost-sharing or matching.

Discussion: The Department has a long-standing practice not to allow the use of unrecovered indirect costs under training grants as matching or cost-sharing. This practice was required because under a previous version of OMB Circular A-110 and the Department's implementing regulations in 34 CFR Part 74, only allowable costs could be used for matching or cost-sharing purposes. Since training grants are limited to an eight percent indirect cost rate, all indirect costs over that limit were considered unallowable and thus could not be used as matching or cost-sharing. The practice also had the result of maximizing the funds that support project activities, because the use of unrecovered indirect costs to meet matching or cost-sharing requirements would reduce the amount of direct cost funds being put into the project by the recipient.

The Department recently revised 34 CFR Part 74 to implement revisions to OMB Circular A-110. The circular and Part 74 now allow institutions of higher education, non-profit organizations, and hospitals that receive funds under Federal programs to use unrecovered indirect costs for matching or cost-sharing, but only with the approval of the awarding agency. In light of this change and in response to the concerns expressed by commenters, the Secretary re-examined this practice but decided not to change it because it maximizes the impact of the limited funds available for training grant programs.

Changes: None.

Comments: The Department received comments suggesting that applicants be notified as early as possible in the application process that a program is subject to the training rate or to the restricted rate based on a statutory supplement-not-supplant requirement. Commenters thought this information should be included in the application packages and also on the grant award notices.

Discussion: Many programs already include this information in

application packages and notices, but, in an effort to assist applicants as much as possible, the Department will do this for the other programs as well. The issue is somewhat complicated by the fact that some, but not all, grants awarded under certain programs may be training grants. In this case the Department will include in the application package and notice a statement that some grants awarded under the program could be training grants subject to the eight percent limitation on indirect costs, depending upon the type of project proposed. The Department is already taking steps to include information in the Catalog of Federal Domestic Assistance that identifies those programs subject to the restricted rate based on the supplement-not-supplant requirement. As for placing the information on the award notices, the Department is currently redesigning its core financial systems, including the grants management system, and this information will be on award notices produced under the new system. These notification issues were not addressed in the proposed regulations and no change has been made to include them in the final regulations.

Changes: None.

Comments: A few commenters thought that the Department should exclude training grants and their indirect costs from the process used by the Department to establish indirect cost rates. This would have the effect of increasing the organization's negotiated rate and would offset somewhat the loss of indirect costs under the training grants.

Discussion: This issue was not included in the proposed regulations but will be considered by the Department during its periodic reviews of administrative procedures.

Changes: None.

#### **Section 75.563 Restricted Indirect Cost Rate--Programs Covered**

Comments: One commenter said that the restricted rates applicable to programs with the supplement-not-supplant requirement should not be applied to universities that have a negotiated indirect cost rate. They suggested that Secs. 75.563 and 75.564(f) be deleted.

Discussion: The Department applies a restricted rate only to grants made under programs that have a statutory requirement that Federal funds be used to supplement, not supplant, institutional funds. If a recipient happens to be an institution of higher education, the restricted rate must be applied--the Department has no choice on the matter because the rate implements a statutory limitation. However, as a matter of practice, the recipients of grants under these programs are predominately State educational agencies or local educational agencies;

very few institutions of higher education receive grants under restricted rate programs.

Changes: None.

#### Section 75.564 Reimbursement of Indirect Costs

Comments: Several commenters thought the language in Sec. 75.564(a) was confusing and contradicts Sec. 75.564(b) and Sec. 75.560(d). They thought Sec. 75.564(a) should be revised to make it clear that the Department accepts the rate negotiated with an applicant's cognizant agency.

Discussion: This section addresses the issue of reimbursement of indirect costs and the opening paragraph is a general statement of the Department's policies in this area. As stated in the first sentence, there are administrative and statutory restrictions that affect the reimbursement of indirect costs under programs administered by ED. There are also situations, though infrequent, when indirect costs are not reimbursed due to a lack of funds. This usually occurs when a grantee is seeking reimbursement of indirect costs because the applicable rate was adjusted upwards during or after the performance of the grant. The Secretary agrees that the second sentence in this section is somewhat confusing and has made a change.

Changes: The second sentence in Sec. 75.564(a), "The extent to which indirect costs are reimbursed is a matter for determination between the Secretary and the grantee," has been deleted from the final regulation.

Comments: The Department received comments that construction grants and grants in support of conferences should not be included in the list of grants in Sec. 75.564(c) for which indirect costs are unallowable. The commenters think these types of grants do carry considerable administrative costs and ED should reimburse recipients for their indirect costs. One commenter suggested that the language concerning conferences be revised to apply to grants made exclusively to support conferences.

Discussion: The Department does not agree that construction grants carry the same administrative costs as other types of grants. Most of the construction work funded by those grants is carried out under subcontracts, a practice which results in recipients incurring relatively little overhead expense in comparison to other types of grants. Also, unlike other products of grant-supported activities, the costs of a building can be recovered through depreciation or use

allowances. Therefore no change has been made concerning construction grants, but the language on grants for conferences has been revised.

**Changes:** Section 75.564(c)(6) has been revised to apply to grants made exclusively to support conferences.

**Comments:** Several commenters thought Sec. 75.564(e) prohibits the use of indirect costs to satisfy matching or cost-sharing requirements and so should be revised or deleted as inconsistent with OMB Circulars A-21 and A-110.

**Discussion:** The OMB circulars that serve as cost principles or administrative guidance for grant recipients all contain the requirement that only allowable costs may be charged to a Federal grant as either direct or indirect costs. The same principle applies to funds used for matching or cost-sharing. However, the re-statement of this principle in these regulations has caused some confusion, particularly since a change to OMB Circular A-110, recently adopted by the Department as 34 CFR Part 74, gives granting agencies the option of approving unrecovered indirect costs to satisfy matching or cost-sharing requirements. The Department has therefore decided to delete the proposed Sec. 75.564(e) from the final regulations.

As discussed elsewhere in this document, the Department is continuing its practice of prohibiting the use of unrecovered indirect costs to satisfy matching or cost-sharing requirements under training and restricted rate grants. For grantees subject to 34 CFR Part 74, the Department will consider on a case-by-case basis requests to use unrecovered indirect costs as matching or cost-sharing when the grant in question is not a training grant or a grant subject to a restricted indirect cost rate.

**Changes:** The proposed Sec. 75.564(e) has been deleted.

**Comments:** The Department received one comment that Sec. 75.564(f) should be deleted and each member of a group of eligible parties be allowed to apply its own indirect cost rate to its portion of the grant funds.

**Discussion:** It has been the Department's policy on certain indirect cost matters--for example, the eight percent training rate--to maximize the Federal funds going to support program activities. If the official recipient of the grant applies its rate to the full award amount and each member of the group applies its full rate to its portion of the grant, as has happened in such situations, a disproportionate amount of the grant is spent on indirect costs. Since the Department wishes to

maximize the funds supporting the direct costs of a project, it is limiting the indirect costs for grants made to groups of eligible parties to the rate of the official grant recipient, the fiscal agent for the group. The members of the group can decide among themselves how the funds should be divided within the group.

Changes: No change was made to the text of this paragraph, but, since the proposed Sec. 75.564(e) has been deleted, this paragraph has been redesignated as Sec. 75.564(e) in these final regulations.

#### **Section 76.560 General indirect cost rates; exceptions.**

Since the Department recently adopted the revised OMB Circular A-110 as 34 CFR Part 74, references in this section have been revised to be consistent with the new 34 CFR Part 74.

#### **Section 76.561 Approval of indirect cost rates.**

The Department has revised this section to be consistent with the corresponding section of 34 CFR Part 75 so that State educational agencies may approve multi-year indirect coststop rates for recipients subject to 34 CFR Part 76.

#### **Section 76.564 Restricted indirect cost rate--formula.**

The Department has made a revision to this section to make its requirements consistent with similar requirements in 34 CFR Part 75. Specifically, Sec. 76.564(d) has been revised to prohibit the use of unrecovered indirect costs under a restricted rate grant to satisfy matching or cost-sharing requirements. This change is consistent with current departmental practices and with the restriction placed on training grants in Sec. 75.562(c)(3).

#### **Section 76.565 General management costs--restricted rate.**

Comments: Several commenters found the language in Sec. 76.565 concerning organization-wide activities to be unclear. Some of the commenters thought that the proposed regulations did not make it clear that some activities considered divisional administration may in fact be organization-wide activities, such as payroll or personnel functions.

Discussion: The Department agrees with these commenters and has changed the wording in an attempt to make the final version clearer to readers.

**Changes:** The wording of Sec. 76.565(a) has been changed to clarify the meaning of the term organization-wide. Section 76.565(c) has been revised to clarify the use of the term divisional administration.

**Comments:** One commenter said a deputy chief executive officer who oversees general management activities should not be excluded as required in Sec. 76.565 (c) and (d). Another said that chief executive officers should be excluded only if their activities are limited to one component.

**Discussion:** Chief executive officers and their deputies are positions that would exist whether or not the organization received Federal funds. To support them with Federal funds would be supplanting, which is prohibited under restricted rate programs.

**Changes:** None.

**Comments:** One commenter disagreed with the definition of component in Sec. 76.565(d)(2), saying it conflicts with the generally accepted accounting standard that an agency is a component of a State. The commenter maintains that the proposed definition of a component as an organizational unit within an agency would prohibit States from charging legitimate administrative costs to a grant.

**Discussion:** As stated in Sec. 76.563, this section applies to "agencies of State and local governments," most commonly the State educational agency, not to the State itself. In this context, the component would be an organizational unit within a State agency, as described in the regulation. No change has been made in this section.

**Changes:** None.

#### **Section 76.567 Other expenditures--restricted rate.**

**Comments:** The Department received one comment that subgrants should be excluded from other expenditures, since their inclusion would distort the indirect cost calculation and subgrants are already excluded from the base in the formula in Sec. 76.569.

**Discussion:** The Department agrees with this comment and has made a change.

**Changes:** Section 76.567(b) has been revised to exclude subgrants from other expenditures.

## **Section 76.568 Occupancy and space maintenance costs--restricted rate.**

Comments: One commenter thought the last two sentences of Sec. 76.568(c) should be deleted as inconsistent with other Federal guidance in OMB Circular A-87 and OASC-10, that States cannot afford to pay for the office space occupied by Federal program staff.

Discussion: The sentences in question are not intended to indicate that the costs of office space for Federal program staff must be borne by the States, nor are they inconsistent with other Federal guidance. Costs of space can be charged as indirect or direct costs as appropriate, but Federal funds cannot be used to supplant local funds under programs with statutory prohibitions of supplanting. The last sentence merely reiterates the standard practice that the Secretary approves the budgets of projects supported by grant funds. No changes have been made to this section.

Changes: None.

## **Paperwork Reduction Act of 1980**

These regulations have been examined under the Paperwork Reduction Act of 1980 and have been found to contain no information collection requirements.

## **Assessment of Educational Impact**

In the notice of proposed rulemaking, the Secretary requested comments on whether the proposed regulations would require transmission of information that is being gathered by or is available from any other agency or authority of the United States.

Based on the response to the proposed rules and on its own review, the Department has determined that the regulations in this document do not require transmission of information that is being gathered by or is available from any other agency or authority of the United States.

## **List of Subjects 34 CFR Part 75**

Education Department, Grant programs--education, Grant administration, Incorporation by reference.

## **List of Subjects in 34 CFR Part 76**

Education Department, Grant programs--education, Grant administration, Intergovernmental relations, State-administered programs.

(Catalog of Federal Domestic Assistance Number does not apply.)

Dated: November 10, 1994.

Richard W. Riley,  
Secretary of Education.

The Secretary amends Parts 75 and 76 of Title 34 of the Code of Federal Regulations as follows:

## PART 75--DIRECT GRANT PROGRAMS

1. The authority citation for Part 75 continues to read as follows:

Authority: 20 U.S.C. 1221e-3(a)(1) and 3474, unless otherwise noted.

2. Section 75.129 is amended by revising paragraphs (a) (1) and (2) and adding paragraph (a)(3), to read as follows:

**Sec. 75.129 Legal responsibilities of each member of the group.**

(a) \* \* \*

- (1) The use of all grant funds;
- (2) Ensuring that the project is carried out by the group in accordance with Federal requirements; and
- (3) Ensuring that indirect cost funds are determined as required under Sec. 75.564(e).

\* \* \* \* \*

3. Section 75.560 is amended by revising paragraphs (a) (1), (2), (3), (4), and (5), by revising paragraph (b), by adding new paragraphs (c) and (d), by and revising the authority citation at the end of the section, to read as follows:

**Sec. 75.560 General indirect cost rates; exceptions.**

(a) \* \* \*

- (1) Institutions of higher education, at 34 CFR 74.27;
- (2) Hospitals, at 34 CFR 74.27;
- (3) Other nonprofit organizations, at 34 CFR 74.27;
- (4) Commercial (for-profit) organizations, at 34 CFR 74.27; and
- (5) State and local governments and federally-recognized Indian tribal organizations, at 34 CFR 80.22.

(b) A grantee must have a current indirect cost rate agreement to charge indirect costs to a grant. To obtain an indirect cost rate, a grantee must submit an indirect cost proposal to its cognizant agency and negotiate an indirect cost rate agreement.

(c) The Secretary may establish a temporary indirect cost rate for a grantee that does not have an indirect cost rate agreement with its cognizant agency.

(d) The Secretary accepts an indirect cost rate negotiated by a grantee's cognizant agency, but may establish a restricted indirect cost rate for a grantee to satisfy the statutory requirements of certain programs administered by the Department.

(Authority: 20 U.S.C. 1221e-3(a)(1) and 3474)

4. Section 75.561 is revised to read as follows:

**Sec. 75.561 Approval of indirect cost rates.**

(a) If the Department of Education is the cognizant agency, the Secretary approves an indirect cost rate for a grantee other than a local educational agency. For the purposes of this section, the term local educational agency does not include a State agency.

(b) Each State educational agency, on the basis of a plan approved by the Secretary, shall approve an indirect cost rate for each local educational agency that requests it to do so. These rates may be for periods longer than a year if rates are sufficiently stable to justify a longer period.

(c) The Secretary generally approves indirect cost rate agreements annually. Indirect cost rate agreements may be approved for periods longer than a year if the Secretary determines that rates will be sufficiently stable to justify a longer rate period.

(Authority: 20 U.S.C. 1221e-3(a)(1) and 3474)

5. Section 75.562 is revised to read as follows:

**Sec. 75.562 Indirect cost rates for educational training projects.**

(a) Educational training grants provide funding for training or other educational services. Examples of the work supported by training grants are summer institutes, training programs for selected participants, the introduction of new or expanded courses, and similar instructional undertakings that are separately budgeted and accounted for by the sponsoring institution. These grants do not usually support activities involving research, development, and dissemination of new educational materials and methods. Training grants largely implement previously developed materials and methods and require no significant

adaptation of techniques or instructional services to fit different circumstances.

(b) The Secretary uses the definition in paragraph (a) to determine which grants are educational training grants.

(c) Indirect cost reimbursement on a training grant is limited to the recipient's actual indirect costs, as determined by its negotiated indirect cost rate agreement, or eight percent of a modified total direct cost base, whichever amount is less. For the purposes of this section, a modified total direct cost base is defined as total direct costs less stipends, tuition and related fees, and capital expenditures of \$5,000 or more.

(1) The eight percent limit also applies to cost-type contracts under grants, if these contracts are for training as defined in this section.

(2) The eight percent limit does not apply to agencies of State or local governments, including federally recognized Indian tribal governments, as defined in 34 CFR 80.3.

(3) Indirect costs in excess of the eight percent limit may not be charged directly, used to satisfy matching or cost-sharing requirements, or charged to another Federal award.

(d) A grantee using the training rate of eight percent is required to have documentation available for audit that shows that its negotiated indirect cost rate is at least eight percent.

(Authority: 20 U.S.C. 1221e-3(a)(1) and 3474)

6. Section 75.563 is revised to read as follows:

**Sec. 75.563 Restricted indirect cost rate--programs covered.**

If a grantee decides to charge indirect costs to a program that has a statutory requirement prohibiting the use of Federal funds to supplant non-Federal funds, the grantee shall use a restricted indirect cost rate computed under 34 CFR 76.564 through 76.569.

(Authority: 20 U.S.C. 1221e-3(a)(1) and 3474)

7. Sections 75.564 through 75.568 are removed.

8. A new Sec. 75.564 is added to read as follows:

**Sec. 75.564 Reimbursement of indirect costs.**

- (a) Reimbursement of indirect costs is subject to the availability of funds and statutory or administrative restrictions.
- (b) The application of the rates and the determination of the direct cost base by a grantee must be in accordance with the indirect cost rate agreement approved by the grantee's cognizant agency.
- (c) Indirect cost reimbursement is not allowable under grants for--
  - (1) Fellowships and similar awards if Federal financing is exclusively in the form of fixed amounts such as scholarships, stipend allowances, or the tuition and fees of an institution;
  - (2) Construction grants;
  - (3) Grants to individuals;
  - (4) Grants to organizations located outside the territorial limits of the United States;
  - (5) Grants to Federal organizations; and
  - (6) Grants made exclusively to support conferences.
- (d) Indirect cost reimbursement on grants received under programs with statutory restrictions or other limitations on indirect costs must be made in accordance with the restrictions in 34 CFR 76.564 through 76.569.
- (e) Indirect costs for a group of eligible parties (see Secs. 75.127-75.129) are limited to the amount derived by applying the rate of the applicant, or a restricted rate when applicable, to the grant in keeping with the terms of the applicant's indirect cost rate agreement.

(Authority: 20 U.S.C. 1221e-3(a)(1) and 3474)

**PART 76--STATE-ADMINISTERED PROGRAMS**

9. The authority citation for Part 76 continues to read as follows:

Authority: 20 U.S.C. 1221e-3(a)(1), 2831(a), 2974(b), and 3474, unless otherwise noted.

10. Section 76.560 is amended by revising paragraphs (a)(1), (2), (3), (4), and (5), by revising paragraph (b), by adding new paragraphs (c) and (d), and revising the authority citation at the end of the section, to read as follows:

**Sec. 76.560 General indirect cost rates; exceptions.**

(a) \* \* \*

- (1) Institutions of higher education, at 34 CFR 74.27;
- (2) Hospitals, at 34 CFR 74.27;
- (3) Other nonprofit organizations, at 34 CFR 74.27;
- (4) Commercial (for-profit) organizations, at 34 CFR 74.27; and
- (5) State and local governments and federally-recognized Indian tribal organizations, at 34 CFR 80.22.

(b) A grantee must have a current indirect cost rate agreement to charge indirect costs to a grant. To obtain an indirect cost rate, a grantee must submit an indirect cost proposal to its cognizant agency and negotiate an indirect cost rate agreement.

(c) The Secretary may establish a temporary indirect cost rate for a grantee that does not have an indirect cost rate agreement with its cognizant agency.

(d) The Secretary accepts an indirect cost rate negotiated by a grantee's cognizant agency, but may establish a restricted indirect cost rate for a grantee to satisfy the statutory requirements of certain programs administered by the Department.

(Authority: 20 U.S.C. 1221e-3(a)(1), 2831(a), 2974(b), and 3474)

11. Section 76.561 is revised to read as follows:

**Sec. 76.561 Approval of indirect cost rates.**

(a) If the Department of Education is the cognizant agency, the Secretary approves an indirect cost rate for a State agency and for a subgrantee other than a local educational agency. For the purposes of this section, the term local educational agency does not include a State agency.

(b) Each State educational agency, on the basis of a plan approved by the Secretary, shall approve an indirect cost rate for each local educational agency that requests it to do so. These rates may be for periods longer than a year if rates are sufficiently stable to justify a longer period.

(c) The Secretary generally approves indirect cost rate agreements annually. Indirect cost rate agreements may be approved for periods longer than a year if the Secretary determines that rates will be sufficiently stable to justify a longer rate period.

(Authority: 20 U.S.C. 1221e-3(a)(1), 2381(a), and 3474)

12. Section 76.563 is revised to read as follows:

**Sec. 76.563 Restricted indirect cost rate--programs covered.**

- Sections 76.564 through 76.569 apply to agencies of State and local governments that are grantees under programs with a statutory requirement prohibiting the use of Federal funds to supplant non-Federal funds, and to their subgrantees under these programs.

(Authority: 20 U.S.C. 1221e(a)(1), 2831(a), 2974(b), and 3474)

13. A new Sec. 76.564 is added to read as follows:

**Sec. 76.564 Restricted indirect cost rate--formula.**

- (a) An indirect cost rate for a grant covered by Sec. 76.563 or 34 CFR 75.563 is determined by the following formula:

Restricted indirect cost rate = (General management costs + Fixed costs) <divide> (Other expenditures)

(b) General management costs, fixed costs, and other expenditures must be determined under Secs. 76.565 through 76.567.

(c) Under the programs covered by Sec. 76.563, a subgrantee of an agency of a State or a local government (as those terms are defined in 34 CFR 80.3) or a grantee subject to 34 CFR 75.563 that is not a State or local government agency may use--

(1) An indirect cost rate computed under paragraph (a) of this section; or

(2) An indirect cost rate of eight percent unless the Secretary determines that the subgrantee or grantee would have a lower rate under paragraph (a) of this section.

(d) Indirect costs that are unrecovered as a result of these restrictions may not be charged directly, used to satisfy matching or cost-sharing requirements, or charged to another Federal award.

(Authority: 20 U.S.C. 1221e-3(a)(1), 2831(a), 2974(b), and 3474)

14. A new Sec. 76.565 is added to read as follows:

**Sec. 76.565 General management costs--restricted rate.**

(a) As used in Sec. 76.564, general management costs means the costs of activities that are for the direction and control of the grantee's affairs that are organization-wide. An activity is not organization-wide if it is limited to one activity, one component of the grantee, one subject, one phase of operations, or other single responsibility.

(b) General management costs include the costs of performing a service function, such as accounting, payroll preparation, or personnel management, that is normally at the grantee's level even if the function is physically located elsewhere for convenience or better management. The term also includes certain occupancy and space maintenance costs as determined under Sec. 76.568.

(c) The term does not include expenditures for--

- (1) Divisional administration that is limited to one component of the grantee;
- (2) The governing body of the grantee;
- (3) Compensation of the chief executive officer of the grantee;
- (4) Compensation of the chief executive officer of any component of the grantee; and
- (5) Operation of the immediate offices of these officers.

(d) For purposes of this section--

- (1) The chief executive officer of the grantee is the individual who is the head of the executive office of the grantee and exercises overall responsibility for the operation and management of the organization. The chief executive officer's immediate office includes any deputy chief executive officer or similar officer along with immediate support staff of these individuals. The term does not include the governing body of the grantee, such as a board or a similar elected or appointed governing body; and
- (2) Components of the grantee are those organizational units supervised directly or indirectly by the chief executive officer. These organizational units generally exist one management level below the executive office of the grantee. The term does not include the office of the chief executive officer or a deputy chief executive officer or similar position.

(Authority: 20 U.S.C. 1221e-3(a)(1), 2831(a), 2974(b), and 3474)

15. A new Sec. 76.566 is added to read as follows:

**Sec. 76.566 Fixed costs—restricted rate.**

As used in Sec. 76.564, fixed costs means contributions of the grantee to fringe benefits and similar costs, but only those associated with salaries and wages that are charged as indirect costs, including--

- (a) Retirement, including State, county, or local retirement funds, Social Security, and pension payments;
- (b) Unemployment compensation payments; and
- (c) Property, employee, health, and liability insurance.

(Authority: 20 U.S.C. 1221e-3(a)(1), 2831(a), 2974(b), and 3474)

16. A new Sec. 76.567 is added to read as follows:

**Sec. 76.567 Other expenditures—restricted rate.**

(a) As used in Sec. 76.564, other expenditures means the grantee's total expenditures for its federally- and non-federally-funded activities in the most recent year for which data are available. The term also includes direct occupancy and space maintenance costs as determined under Sec. 76.568 and costs related to the chief executive officers of the grantee and components of the grantee and their offices (see Sec. 76.565(c) and (d)).

(b) The term does not include--

- (1) General management costs determined under Sec. 76.565;
- (2) Fixed costs determined under Sec. 76.566;
- (3) Subgrants;
- (4) Capital outlay;
- (5) Debt service;
- (6) Fines and penalties;
- (7) Contingencies; and
- (8) Election expenses. However, the term does include election expenses that result from elections required by an applicable Federal statute.

(Authority: 20 U.S.C. 1221e-3(a)(1), 2831(a), 2974(b), and 3474)

17. A new Sec. 76.568 is added to read as follows:

**Sec. 76.568 Occupancy and space maintenance costs--restricted rate.**

(a) As used in the calculation of a restricted indirect cost rate, occupancy and space maintenance costs means such costs as--

- (1) Building costs whether owned or rented;
- (2) Janitorial services and supplies;
- (3) Building, grounds, and parking lot maintenance;
- (4) Guard services;
- (5) Light, heat, and power;
- (6) Depreciation, use allowances, and amortization; and
- (7) All other related space costs.

(b) Occupancy and space maintenance costs associated with organization-wide service functions (accounting, payroll, personnel) may be included as general management costs if a space allocation or use study supports the allocation.

(c) Occupancy and space maintenance costs associated with functions that are not organization-wide must be included with other expenditures in the indirect cost formula. These costs may be charged directly to affected programs only to the extent that statutory supplanting prohibitions are not violated. This reimbursement must be approved in advance by the Secretary.

(Authority: 20 U.S.C. 1221e-3(a)(1), 2831(a), 2974(b), and 3474)

18. A new Sec. 76.569 is added to read as follows:

**Sec. 76.569 Using the restricted indirect cost rate.**

(a) Under the programs referenced in Sec. 76.563, the maximum amount of indirect costs under a grant is determined by the following formula:

Indirect costs=(Restricted indirect cost rate) x (Total direct costs of the grant minus capital outlays, subgrants, and other distorting or unallowable items as specified in the grantee's indirect cost rate agreement)

(b) If a grantee uses a restricted indirect cost rate, the general management and fixed costs covered by that rate must be excluded by the grantee from the direct costs it charges to the grant.

(Authority: 20 U.S.C. 1221e-3(a)(1), 2831(a), 2974(b), and 3474)  
[FR Doc. 94-28368 Filed 11-16-94; 8:45 am]

## **APPENDIX IV**

### **Listing of Restricted Rate Programs**

<sup>147</sup> 126

## Restricted Rate Listing (Master List)

CFDA #	Title	Organization
84.003A	Transitional Bilingual Education Program	OBEMLA
84.003B	Developmental - Special Comp Middle School Priority	OBEMLA
84.003C	Developmental Bilingual Education Program	OBEMLA
84.003D	Transitional Bilingual Education - Math / Science Priority	OBEMLA
84.003	Special Alternative Instructional Program	OBEMLA
84.003F	Special Alternative Special Comp Middle School Priority	OBEMLA
84.003K	Special Alternative Instructional Program - Math / Science	OBEMLA
84.003L	Special Populations Program	OBEMLA
84.003M	Transitional Bilingual Ed. Special Comp - Recent Arrival Priority	OBEMLA
84.003N	Special Alternative / Special Comp Recent Arrival Priority	OBEMLA
84.288S	Bilingual Education: Program Development and Implementation Grants	OBEMLA
84.289P	Bilingual Education : Program Enhancement Grants	OBEMLA
84.290U	Bilingual Education: Comprehensive School Grant	OBEMLA
84.291R	Bilingual Education: System Wide Improvement Grants	OBEMLA
84.010A	Title I Programs: Local Education Agencies	OESE
84.011A	Migrant Education: Basic State Formula Grant Program	OESE
84.041	Impact Aid Program	OESE
84.060A	Indian Education - Local Education Agencies	OESE
84.186A	Drug-free Schools / Community Prog - State and Local Program	OESE
84.207A	Drug-free Schools and Community / School Personnel Training	OESE
84.216A	Capital Expenses / Private Schools	OESE
84.241A	Drug-free Schools: Counselor Training	OESE
84.277A	Safe Schools Act	OESE
84.282A	Charter Schools	OESE
84.298A	Innovative Education Program Strategies	OESE
84.994J	Safe Schools Act	OESE
84.995A	Compensatory Education Grant Back Awards - Reimbursable	OESE
84.203A	Star School Program	OERI
84.203B	Star School Program Special Statewide	OERI
84.203C	Star School Program Dissemination	OERI
84.215S	Elementary School Counseling and Demonstration Project	OERI
84.994T	National Writing Project	OERI
84.002A	Adult Education: State Grant Program	OVAE
84.048A	Vocational Education: Basic Grants to States	OVAE
84.048B*	Pacific Vocational Educational Improvement Project	OVAE
84.049*	Vocational Education - Consumer and Homemaking Education	OVAE
84.051*	National Vocational Education Research - NCRVE	OVAE
84.053*	Vocational Education: State Councils	OVAE
84.077*	Bilingual Vocational Training	OVAE
84.099*	Bilingual Vocational Instructor Training	OVAE
84.101*	Vocational Education: Indian Set-Aside	OVAE
84.174*	Vocational Education: Community Based Organizations Pre 94	OVAE
84.193*	Demonstration Center for the Training of Dislocated Workers	OVAE
84.199*	Cooperative Demonstration Programs	OVAE
84.243*	Tech-Prep Education	OVAE
84.244*	Business and Education Standards	OVAE
84.245*	Tribally Controlled Postsecondary VOC Institutions	OVAE
84.248*	Integration of Vocational and Academic Learning	OVAE
84.253*	Vocational Education: Supplementary Grants	OVAE
84.259*	Native Hawaiian Vocational Education	OVAE

<b>84.027A</b>	<b>Handicapped-State Grants</b>	<b>OSERS</b>
<b>84.173A</b>	<b>Handicapped-Preschool Grants</b>	<b>OSERS</b>
<b>84.181A</b>	<b>Special Education: Grants for Infants and Families with Disabilities</b>	<b>OSERS</b>
<b>84.224A</b>	<b>State Grants for Assistive Technology</b>	<b>OSERS</b>
<b>84.231A</b>	<b>Innovation and Demonstration Technology Grants</b>	<b>OSERS</b>
<b>84.031A</b>	<b>Strengthening Program</b>	<b>OPE</b>
<b>84.031B</b>	<b>IAP - Strengthening HBCU Program</b>	<b>OPE</b>
<b>84.031G</b>	<b>Endowment Grant Program</b>	<b>OPE</b>
<b>84.031S</b>	<b>Strengthening Institutions - Hispanic Serving Inst.</b>	<b>OPE</b>
<b>84.142A</b>	<b>College Facilities Loan Program</b>	<b>OPE</b>
<b>84.153A</b>	<b>Business International Education</b>	<b>OPE</b>
<b>84.220A</b>	<b>Centers for International Business</b>	<b>OPE</b>
<b>84.269A</b>	<b>Institute for International Public Policy</b>	<b>OPE</b>
<b>84.274A</b>	<b>American Overseas Research Centers</b>	<b>OPE</b>

\* Any funds awarded under the Perkins Act are subject to a restricted rate when used jointly with funds awarded under JTPA (section 123, Title II, and Title III). Additionally, funds awarded under Title II of the Perkins Act are always subject to a restricted indirect cost rate regardless of how they are used.

## APPENDIX V

### Indirect Cost Rate Agreement

**SAMPLE**

INDIRECT COST RATE AGREEMENT  
STATE EDUCATION AGENCY

ORGANIZATION:

DATE: \_\_\_\_\_

AGREEMENT NO. \_\_\_\_\_

FILING REFERENCE: This replaces  
previous Agreement No. \_\_\_\_\_  
dated \_\_\_\_\_

The purpose of this Agreement is to establish indirect cost rates for use in awarding and managing of Federal contracts, grants, and other assistance arrangements to which Office of Management and Budget (OMB) Circular A-87 applies. The rates were negotiated by the U.S. Department of Education pursuant to the authority cited in Attachment A of OMB Circular A-87.

This agreement consists of four parts: Section I - Rates and Bases; Section II - Particulars; Section III - Special Remarks; and, Section IV -Approvals.

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**Section I - Rate(s) and Base(s)**

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TYPE	<u>Effective Period</u>				<u>Coverage</u>	
	From	To	Rate	Base	Location	Applicability
Fixed	07-01-96	06-30-97	. %	1/	All	Unrestricted
Fixed	07-01-96	06-30-97	. %	1/	All	Restricted 2/

1/ Total direct cost less items of equipment, alterations and renovations, flow-through funds and that portion of each subaward in excess of \$25,000.

2/ All Federal programs which require the use of a restricted rate as defined by 34 CFR 76.563 and 34 CFR 76.563.

**Treatment of Fringe Benefits:** Fringe benefits applicable to direct salaries and wages are treated as direct costs.

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Section II - Particulars

SCOPE: The indirect cost rate(s) contained herein are for use with grants, contracts, and other financial assistance agreements awarded by the Federal Government to the and subject to OMB Circular A-87.

LIMITATIONS: Application of the rate(s) contained in this agreement is subject to all statutory or administrative limitations on the use of funds, and payment of costs hereunder is subject to the availability of appropriations applicable to a given grant or contract. Acceptance of the rate(s) agreed to herein is predicated on the conditions: (A) that no costs other than those incurred by the State Education Agency were included in indirect cost pools as finally accepted, and that such costs are legal obligations of the State Education Agency and applicable under the governing cost principles; (B) that the same costs that have been treated as indirect costs are not claimed as direct costs; © that similar types of information which are provided by the State Education Agency, and which were used as a basis for acceptance of rates agreed to herein, are not subsequently found to be materially incomplete or inaccurate; and (D) that similar types of costs have accorded consistent accounting treatment.

ACCOUNTING CHANGES: Fixed or predetermined rates contained in this agreement are based on the accounting system in effect at the time the agreement was negotiated. When changes to the method of accounting for cost affect the amount of reimbursement resulting from the use of these rates, the changes will require the prior approval of the authorized representative of the cognizant negotiation agency. Such changes include, but are not limited to, changing a particular type of cost from an indirect to a direct charge. Failure to obtain such approval may result in subsequent cost disallowances.

FIXED RATE: The negotiated rate is based on an estimate of the costs which will be incurred during the period to which the rate applies. When the actual costs for such period have been determined, an adjustment will be made in a subsequent negotiation to compensate for the difference between the cost used to establish the fixed rate and the actual costs.

NOTIFICATION TO OTHER FEDERAL AGENCIES: Copies of this document may be provided to other Federal agencies as a means of notifying them of the agreement contained herein.

AUDIT: If a rate in this Agreement contains amounts from a cost allocation plan, future audit adjustments which affect this cost allocation plan will be compensated for during the rate approval process of a subsequent year.

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Section III - Special Remarks

1. This agreement is effective on the date of approval by the Federal Government.
2. Questions regarding this agreement should be directed to the Negotiator.
3. Approval of the rate(s) contained herein does not establish acceptance of the State Education Agency's total methodology for the computation of indirect cost rates for years other than the year(s) herein cited.

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Section IV - Approvals

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For the State Education Agency:

For the Federal Government:

U.S. Department of Education  
600 Independence Avenue, SW  
Room 3523, ROB #3  
Washington, DC 20202-4201

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Signature

---

Signature

---

Name

---

Richard T. Mueller, Chief  
Name

---

Title

---

Indirect Cost Group  
Title

---

Date

---

Date

---

Negotiator

---

(202) 708-  
Telephone Number

## **APPENDIX VI**

### **Sample Methodology for a Local Education Agency**

## **Definitions**

### **Direct Costs**

To prepare an indirect cost proposal, total costs, regardless of funding source, must be classified into one or the following categories: direct, indirect, exclusion, or unallowable. Direct costs are those that can be identified specifically with a particular cost objective. The direct costs of a federal grant or contract can be specifically identified as benefiting the program; therefore, they may be charged directly to the program. Examples of direct costs that may be charged to a federal program include the following:

1. Compensation of the employees who administer the program;
2. Supplies and materials used for the program;
3. Equipment purchases and used for the program; and
4. Travel expenses incurred specifically to carry out the program.

### **Indirect Costs**

OMB Circular A-87, *Cost Principles for State and Local Governments*, defines indirect costs as those that are incurred for a common or joint purpose benefiting more than one cost objective. In addition, indirect costs cannot be readily identified as benefiting a particular cost objective without effort disproportionate to the results achieved. Examples of indirect costs include the salaries and expenses for the following:

1. Data Processing
2. Accounting
3. Personnel
4. Purchasing

Indirect costs cannot be readily identified to benefiting federal programs. Thus, indirect costs are normally charged to federal programs through the indirect cost rate.

School districts should be consistent in treating costs as direct or indirect under federal grants and contracts. Once a cost is treated as direct or indirect, it should be treated that way for all projects and activities, regardless of the source of funding.

## **Exclusions and Unallowables**

The indirect cost rate calculation should exclude pass through funds, major subcontracts and food purchases from the direct and indirect functional areas. Additionally, these same costs should be excluded when calculating the indirect cost reimbursement. These costs are excluded when calculating the rate or reimbursement because they require minimal administrative support.

Unallowable costs include capital expenditures, debt service, fines and penalties, contingencies, and election expenses. The indirect cost rate calculation should eliminate unallowable costs from the direct and indirect functional areas. Also, unallowable costs should be eliminated when calculating the indirect cost reimbursement.

## **Indirect Cost Proposal**

An indirect cost rate proposal is the document that supports the distribution of indirect costs to a direct cost base. An indirect cost rate proposal is prepared using the following steps. First, total costs, regardless of funding source, are identified for each function. Second, exclusions and unallowable costs are eliminated. Third, the total costs, net of exclusions and unallowables, are classified as direct or indirect. Finally, the total direct costs are divided by the total direct costs to determine the rate.

## **Indirect Cost Rate**

An indirect cost rate is the mechanism used to recover indirect costs from federal grants and contracts. The rate can be computed after an indirect cost proposal has been prepared. It is the ratio of total allowable indirect costs to direct costs.

$$\frac{\text{Indirect Cost}}{\text{Direct Cost}} = \text{Indirect Cost Rate}$$

## **Indirect Cost Recoveries**

Indirect cost recoveries are that portion of the grant funding that are used to support the indirect costs of the program. Ideally, indirect cost recoveries should be used to support those functions that are not directly funded by the federal grant. The indirect cost recovery is calculated by multiplying the rate by the indirect cost base.

$$\text{Indirect Cost Rate} \times \text{Direct Cost Base} = \text{Indirect Cost Recoveries}$$

## **Functions and Object Codes that are Exclusions and Unallowable Costs**

The following function and object codes should be classified as exclusions and unallowable costs.  
 (See Exhibit B)

<u>Function Description</u>	<u>Function Code</u>	<u>Classification</u>
Support Services - General Administration	2300	Unallowable
Site Acquisition Services	4100	Unallowable
Site Improvement Services	4200	Unallowable
Architecture & Engineering Services	4300	Unallowable
Educational Specifications Development Services	4400	Unallowable
Building Acquisition & Construction	4500	Unallowable
Building Improvement Services	4600	Unallowable
Other Facilities Acquisition & Construction	4900	Unallowable
Repayment of Debt	5100	Unallowable
Transfers-Out	5200	Exclusion
Advances-Out	5XXX	Exclusion
Other Miscellaneous Use of Funds	5X00	Exclusion
<u>Other Description</u>	<u>Object Code</u>	<u>Classification</u>
Food & Related Supplies & Materials	630	Exclusion
Library Books	640	Unallowable
Livestock	6XX	Unallowable
Land	710	Unallowable
Replacement Land	710	Unallowable
Replacement Building	720	Unallowable
Building	720	Unallowable
Improvements Other Than Buildings	71X	Unallowable
Replacement Other Than Buildings	71X	Unallowable
Equipment	730	Unallowable
Replacement Equipment	730	Unallowable
Vehicles	732	Unallowable
School Buses	732	Unallowable
Other Capital Outlay	7XX	Unallowable
Replacement Vehicles	732	Unallowable
Replacement School Buses	732	Unallowable
Other Capital Outlay	7XX	Unallowable
Judgements	820	Unallowable
Interest	830	Unallowable
Voluntary Contingency Reserve Balance	84X	Unallowable
Contingencies	840	Unallowable
Redemption of Principal	910	Unallowable
Other Debt Service Payment	9XX	Unallowable

Taxes and Assessments	8XX	Unallowable
Refund of Prior Year Receipts	890	Exclusion
Pass Through Payments	9XX	Exclusion
Transfers	930	Exclusion
Advances	9XX	Exclusion
Grant Payments to Other Districts	9XX	Exclusion

### Direct Functions

For the restricted indirect cost rate, the following functions should be classified as direct costs.

<u>Description</u>	<u>Code</u>
Regular Instruction	1100
Special Instruction	1200
Vocational Instruction	1300
Academic & Subject Oriented Activities	1410
Occupation Oriented Activities	141X
Sport Oriented Activities	1420
School & Public Service-Curricular Activities	1490
Adult/Continuing	1600
Other Instruction	1X00
Support Services-Pupils	2100
Support Services-Instructional Staff	2200
Support Services-General Administration	2300
Support Services-School Administration	2400
Operation and Maintenance of Plant Services	2600
Support Services-Pupil Transportation	2800
Food Service Operations	3100
Enterprise Operations	3200
Community Services	3300
Other Operations on Non-Instructional Services	3900

**Restricted Indirect Cost Rate**  
**Classification of Functions Summary**  
**Exhibit A**

<b>Function</b>	<b>Excluded/ Unallowable</b>	<b>Indirect Costs</b>	<b>Direct Costs</b>
<b>1100 Regular Instruction</b>	No	No	Yes
<b>1200 Special Instruction</b>	No	No	Yes
<b>1300 Vocational Instruction</b>	No	No	Yes
<b>1600 Adult/Continuing</b>	No	No	Yes
<b>1X00 Other Instruction</b>	No	No	Yes
<b>1410 Academic &amp; Subject Oriented Activities</b>	No	No	Yes
<b>141X Occupation Oriented Activities</b>	No	No	Yes
<b>1420 Sport Oriented Activities</b>	No	No	Yes
<b>1490 School &amp; Public Service Co-Curricular Activities</b>	No	No	Yes
<b>2100 Support Services-Pupils</b>	No	No	Yes
<b>2200 Support Services-Instructional Staff</b>	No	No	Yes
<b>2300 Support Services-General Education</b>	No	No	Yes
<b>2400 Support Services-School Administration</b>	No	No	Yes
<b>2500 Fiscal Services</b>	No	Yes	No
<b>2500 Support Services-Business</b>	No	Yes	No
<b>2600 Operation and Maintenance of Plant Services</b>	No	No	Yes
<b>2700 Support Services-Pupil Transportation</b>	No	No	Yes
<b>2800 Support Services-Central</b>	No	Yes	No
<b>3100 Food Service Operations</b>	No	No	Yes
<b>3200 Enterprise Operations</b>	No	No	Yes
<b>3300 Community Services</b>	No	No	Yes
<b>3X00 Other Operation of Non-Instructional Services</b>	No	No	Yes
<b>4100 Site Acquisition Services</b>	Yes	No	No
<b>4200 Site Improvement Services</b>	Yes	No	No
<b>4300 Architecture &amp; Engineering Services</b>	Yes	No	No
<b>4400 Educational Specifications Development Services</b>	Yes	No	No
<b>4500 Building Acquisition &amp; Construction</b>	Yes	No	No
<b>4600 Building Improvement Services</b>	Yes	No	No
<b>4900 Other Facilities Acquisition &amp; Construction</b>	Yes	No	No
<b>5100 Repayment of Debt</b>	Yes	No	No
<b>5200 Transfers-Out</b>	Yes	No	No
<b>5XXX Advances-Out</b>	Yes	No	No
<b>5X00 Other Miscellaneous Use of Funds</b>	Yes	No	No

Restricted Indirect Cost Rate					
Cost Classification					
Schedule A					
School Name					
School District Number					
(A)	(B)	(C)	(D)	(E)	(F)
Function		Total Expenditures	Exclusions & Unallowables	Indirect Costs	Direct Costs
1100	Regular Instruction		0		0
1200	Special Instruction		0		0
1300	Vocational Instruction		0		0
1600	Adult/Continuing		0		0
1X00	Other Instruction		0		0
1410	Academic & Subject Oriented Activities		0		0
141X	Occupation Oriented Activities		0		0
1420	Sport Oriented Activities		0		0
1490	School & Public Service Co-Curricular Activities		0		0
2100	Support Services-Pupils		0		0
2200	Support Services-Instructional Staff		0		0
2300	Support Services-General Administration		0		0
2400	Support Services- School Administration		0		0
2500	Fiscal Services		0	0	0
2500	Support Services-Business		0	0	0
2600	Operation & Maintenance of Plant Services		0		0
2700	Support Services-Pupil Transportation		0		0
2800	Support Services-Central		0	0	0
3100	Food Service Operations		0		0
3200	Enterprise Operations		0		0
3300	Community Services		0		0
3X00	Other Operation of Non-Instructional Services		0		0
4100	Site Acquisition Services		0		
4200	Site Improvement Services		0		
4300	Architecture & Engineering Services		0		
4400	Educational Specifications Development Services		0		
4500	Building Acquisition & Construction		0		
4600	Building Improvement Services		0		
4900	Other Facilities Acquisition & Construction		0		
5100	Repayment of Debt		0		
5200	Transfers-Out		0		
5XXX	Advances-Out		0		
5X00	Other Miscellaneous use of Funds		0		
	Total LEA Expenditures	0	0	0	0
			Indirect Costs	0	
			Direct Costs	0	0
Instructions for completing in lotus format:					
1.	For each function code listed in column A input the total expenditures in column C.				
	Do not enter data into columns D, E, or F.				

**BEST COPY AVAILABLE**

<b>Restricted Indirect Cost Rate</b>	
<b>Summary of Excluded and Unallowable Costs</b>	
<b>Exhibit B</b>	
<b>Object Code</b>	<b>Description</b>
<b>630</b>	<b>Food &amp; Related Supplies &amp; Materials</b>
<b>640</b>	<b>Library Books</b>
<b>6XX</b>	<b>Livestock</b>
<b>710</b>	<b>Land</b>
<b>710</b>	<b>Replacement Land</b>
<b>71X</b>	<b>Improvements Other Than Buildings</b>
<b>71X</b>	<b>Replacement Other Than Buildings</b>
<b>720</b>	<b>Buildings</b>
<b>720</b>	<b>Replacement Building</b>
<b>730</b>	<b>Equipment</b>
<b>730</b>	<b>Replacement Equipment</b>
<b>732</b>	<b>Replacement Vehicles</b>
<b>732</b>	<b>Vehicles</b>
<b>732</b>	<b>School Buses</b>
<b>732</b>	<b>Replacement School Buses</b>
<b>7XX</b>	<b>Other Capital Outlay</b>
<b>820</b>	<b>Judgements</b>
<b>830</b>	<b>Interest</b>
<b>840</b>	<b>Contingencies</b>
<b>84X</b>	<b>Voluntary Contingencies Reserve Balance</b>
<b>890</b>	<b>Refund of Prior Year Receipts</b>
<b>8XX</b>	<b>Taxes and Assesments</b>
<b>910</b>	<b>Redemption of Principal</b>
<b>930</b>	<b>Transfers</b>
<b>9XX</b>	<b>Other Debt Service Payment</b>
<b>9XX</b>	<b>Advances</b>
<b>9XX</b>	<b>Grant Payments to Other Districts</b>
<b>9XX</b>	<b>Pass Through Payments</b>

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School District

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County

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IRN

*Sample*

**Indirect Cost Proposal Certification**

I hereby certify that the information contained in the attached indirect cost rate proposal for the fiscal year \_\_\_\_\_ is prepared in conformatnce with the Office of Management and Budget Circular A-87 and the Education Department General and Administrative Regulations. I further certify : (1) that no costs other than those incurred by the grantee/contractor or allocated to the grantee/contractor via an approved central service cost allocation plan were included in its indirect cost pool as finally accepted, and that such incurred costs are legal obligations of the grantee/contractor and allowable under the governing cost principles, (2) that the same costs that have been treated as indirect costs have not been claimed as direct costs, (3) that similar types of costs have been accorded consistent accounting treatment, and (4) that the information provided is not subsequently found to be materially inaccurate.

A fixed with carry-forward restricted rate of \_\_\_\_\_ is requested.

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Signature

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Signature

---

Superintendent's Name

---

Treasurer's Name

---

Date

---

Date

---

If Prepared By External Contractor

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Signature

---

Name of Preparer of Proposal

---

Address

---

County, State, Zip Code

---

Area Code, Telephone Number

## **APPENDIX VII**

### **Sample Local Education Agency Proposal Format**

SAMPLE FORMAT - LOCAL EDUCATION AGENCY INDIRECT COST RATE PROPOSAL \*\*

Actual Costs Year Ended June 30, 1996		UNRESTRICTED RATE			RESTRICTED RATE						
Division/Bureau	Total Costs (a)	Excluded (b)	Unallowable (b)	Indirect	Direct	Total Costs	Excluded (b)	Unallowable (b)	Indirect	Direct	Notes
Food Services	\$6,000,000	\$5,500,000				\$6,000,000	\$5,500,000				(c)
Instruction	90,000,000	80,000				89,920,000	90,000,000	80,000			89,920,000
Principals & Asst. Principals	4,000,000					4,000,000	4,000,000				(d)
Community Services	1,200,000	10,000				1,190,000	1,200,000	10,000			1,190,000
Special Education	5,000,000	300,000				4,700,000	5,000,000	300,000			4,700,000
Vocational Education	7,500,000	600,000				6,900,000	7,500,000	600,000			6,900,000
Adult Education	1,300,000	75,000				1,225,000	1,300,000	75,000			1,225,000
Student Services	900,000	7,000				1,100,000	1,100,000				1,100,000
Job Training Partnership Act	2,400,000	50,000				893,000	900,000				893,000
Inservice Training	1,800,000	6,000				2,350,000	2,400,000	50,000			2,350,000
Materials	200,000	0				1,794,000	1,800,000	6,000			1,794,000
Transportation	8,400,000	120,000				200,000	200,000	0			200,000
Guidance	3,400,000	9,000				8,280,000	8,400,000	120,000			8,280,000
Board of Education	150,000	0				3,391,000	3,400,000	9,000			3,391,000
Other Direct	1,800,000	10,000				150,000	150,000	0			150,000
						1,790,000	1,800,000	10,000			1,790,000
Superintendent's Office	700,000	8,000				692,000	700,000	8,000			692,000
Legal Services	250,000	0				250,000	250,000	0			250,000
Fiscal Services	600,000	7,000				593,000	600,000	7,000			593,000
Personnel Services	500,000	6,000				494,000	500,000	6,000			493,000
Public Relations	300,000	0				200,000	300,000	0			394,000
Plant Operation	8,000,000	15,000				7,985,000	8,000,000	15,000			7,985,750
Plant Maintenance	4,500,000	30,000				4,470,000	4,500,000	30,000			399,250
Procurement Office	300,000	0				300,000	300,000	0			223,500
Policy & Budget Office	400,000	7,000				393,000	400,000	7,000			300,000
											393,000
Subtotals	\$150,700,000	\$6,840,000				\$100,000	\$15,377,000	\$128,383,000			\$12,924,250
Unallowable Costs (b)											\$2,552,750
Totals	\$150,700,000	\$6,840,000				\$0	\$15,377,000	\$128,483,000			\$0
											\$128,383,000
Rate = \$15,377,000 / \$128,483,000 =											12.0%
											RATE = \$2,552,750 / \$141,307,250 =
											1.8%

NOTES:

- (a) Should equal totals for each cost category in local education agency's official financial report. Differences should be reconciled and explained.
- (b) All flow-through, equipment purchase, and alteration and renovation costs are excluded.
- Unallowable costs which generate, or benefit from, the LEA's indirect costs are placed in the base (34 CFR 76.564 (a) and 34 CFR 76.567(a)).
- (c) Costs of Foods and Capital Expenditures are treated as Excluded. Costs of Personnel, Fringe Benefits, Supplies, Travel, and Other Operating are treated as Direct.
- (d) School principals and their staff are not considered indirect because they do not benefit the LEA's total activities. See OMB Circular A-87, Attachment A (C)(3)(b).
- (e) Costs of the Superintendent (and Deputy, if applicable) are direct costs for purposes of calculating Restricted Rate (34 CFR 76.565 (b) and (c); 34 CFR 76.567 (a)).
- If these components report to the Superintendent (or Deputy Superintendent) are "Heads of Components" (34 CFR 76.565(d)(2)), are not allowable indirect costs, (34 CFR 76.565(c)(1)), and their salaries and expenses are placed in the base (34 CFR 76.567 (a)).
- (g) Only allowable Public Relations costs are those "necessary to conduct general liaison with news media and government public relations officers (OMB Circular A-87, Attachment B (d)(3)). Here recipient had incurred unallowable costs to promote itself and other general public relations activities (OMB Circular A-87, Attachment B (f)(e)).
- (h) For Restricted Rate, only allowable Occupancy costs are those associated with "Organization-wide" (e.g. allowable Restricted) indirect activities. Here, space study showed that such activities occupied 5 percent of total work area space. See 34 CFR 76.568.

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The above sample is for guidance purposes only and is not intended to prescribe methods of accounting for costs.

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## **APPENDIX VIII**

### **State Education Agency Delegation for Local Education Agency Indirect Cost Rates**

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LOCAL EDUCATION AGENCY  
DELEGATION AGREEMENT

ORGANIZATION:

Date: \_\_\_\_\_

Agreement No. \_\_\_\_\_

Filing Reference: This replaces  
previous Agreement No. \_\_\_\_\_  
dated \_\_\_\_\_

This Agreement confirms approval and acceptance of the methodology policy and procedures the state education agency (SEA) will use in establishing indirect cost rates for their local education agencies (LEAs). These rates are for use in the award and management of federal contracts, grants and other assistance arrangements governed by Office of Management and Budget (OMB) Circular A-87 and Education Department General Administrative Regulations (EDGAR) 34 CFR parts 75.561 and 76.561 (b) and (c).

The state Superintendent of Education or designated representative is delegated authority to establish indirect cost rates for LEAs in their state. These LEA rates will serve as the sole basis for budgeting and allocation indirect cost reimbursement under federal programs.

The application of LEA indirect cost rates is binding on all federal agencies and subject to periodic review pursuant to single audit requirements for state and local governments.

The effective period of this Agreement is: \_\_\_\_\_ to \_\_\_\_\_.

For the state education agency:

For the federal government

Signature

Signature

Name

Name

Title

Chief Indirect Cost Group

Title

Date

Date

Negotiator

Telephone



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